

**KERALA STATE ELECTRICITY REGULATORY COMMISSION
THIRUVANANTHAPURAM**

PRESENT: Sri.K.J.Mathew, Chairman
Sri.P.Parameswaran, Member
Sri.Mathew George, Member

May 6, 2011

Petition No. OP 37 /2010

In the matter of

Truing up of Accounts of Cochin Special Economic Zone for the year 2006-07

Petition No. OP 38 /2010

In the matter of

Truing up of Accounts of Cochin Special Economic Zone for the year 2007-08

Petition No. OP 39 /2010

In the matter of

Truing up of Accounts of Cochin Special Economic Zone for the year 2008-09

Petition No. OP 1/ 2011

Truing up of Accounts of Cochin Special Economic Zone for the year 2009-10

Cochin Special Economic Zone, Kochi

- Petitioner

ORDER

Background

1. The Cochin Special Economic Zone (*herein after mentioned as CSEZ or licensee*) is a deemed distribution licensee of the Commission. The Commission has been approving the ARR&ERC for CSEZ from 2006-07. As per the directions of the Commission CSEZ had filed the truing up data for three years 2006-07, 2007-08 and 2008-09 vide letter No.3/24/08:Infra:CSEZ/8612 dated 25-11-2009. However, the petition was not in order and later the CSEZ filed the affidavit as required for processing the petition. The Commission sought further additional details vide letter dated 22-7-2010 and scheduled a public hearing on 5-8-2010 at the Office of the Commission. CSEZ had filed additional information vide its letter dated 4-8-2010. A clarification meeting on the accounts of CSEZ

was also held on 20-11-2010. The truing up petition for 2009-10 was filed by CSEZ on 30-12-2010 and the Commission sought clarifications on the petition vide its letter dated 7-1-2011. Public hearing on the petition was held on 23-2-2011 at Conference Hall, CSEZ. As per the accounts provided by CSEZ, the level of approved expenses and actual expenses are as follows:

Particulars	2006-07		2007-08	
	Approved (Rs. lakh)	Actual (Rs. lakh)	Approved (Rs. lakh)	Actual (Rs. lakh)
Power purchase cost	925.80	1,043.06	1,110.18	1,379.49
Interest & financing charges	-	-	-	-
Depreciation	38.11	39.39	38.11	39.77
Employee cost	55.22	54.10	60.74	59.58
R&M Expenses	6.00	7.39	7.48	4.27
A&G Expenses	30.16	29.53	31.45	29.75
Total Expenses	1,055.29	1,173.47	1,247.96	1,512.86
Less Other income	16.00	7.24	16.00	-
Net ARR	1,039.29	1,166.23	1,231.96	1,512.86
Revenue From tariff	1,175.55	1,321.03	1,434.60	1,723.98
Net Surplus/(Gap)	136.26	154.80	202.64	211.12

Particulars	2008-09		2009-10	
	Approved (Rs. lakh)	Actual (Rs. lakh)	Approved (Rs. lakh)	Actual (Rs. lakh)
Power purchase cost	1,526.50	1,390.02	1,679.12	1,451.95
Interest & financing charges	-	-	-	-
Depreciation	39.40	39.77	39.40	39.94
Employee cost	55.98	65.82	61.58	91.54
R&M Expenses	8.23	10.55	9.05	9.80
A&G expenses	33.21	29.81	35.02	11.47
Total Expenses	1,663.32	1,535.97	1,824.17	1,604.70
Less Other income	18.00	-	20.00	96.46
Net Aggregate Revenue Requirements	1,645.32	1,535.97	1,804.17	1,508.24
Revenue From tariff	1,886.18	1,714.63	2,074.79	1,797.03
Net Surplus/(Gap)	240.86	178.66	270.62	288.79

- The Commission decided to consider all petitions together. The petitions are disposed of as detailed in the subsequent sections.

Public Hearing

- The hearing on the petition was held on 5-8-2010 for the years 2006-07 to 2008-09 and on 23-2-2011 for the year 2009-10. Representatives of CSEZ and Kerala

State Electricity Board were present for the hearing. The Board raised following objections:

- a. The entire funds for developing the distribution assets were initially provided by the Government and hence there is no equity for CSEZ. Hence return on Net Fixed Asset criteria maybe employed and surplus if any may be passed on to KSEB.
- b. The thermal surcharge and marginal cost on excess consumption during power restrictions were not reflected in the account for 2008-09.
- c. The capital investment is very low, and the sale of power data shows negative losses. The employee cost per consumer works out to Rs.4514/ consumer / month which is much higher than that of KSEB (Rs.135/consumer/ month). The details regarding the proportionate share of CSEZ employees is not available.
- d. The duty collected is not remitted to the Government.

Analysis and decisions of the Commission

4. The Commission has considered the objections and the reply given by CESZ in finalising the truing up. A clarification meeting was also held on 20-11-2010 with the representatives of the CSEZ. In the meeting details of apportionment methods and details of certain expenses items were sought by the Commission. This was provided by CSEZ on 2-12-2010. In the following section items wise details are analysed.

Energy sales and T&D Loss

5. In 2006-07, the Commission had approved energy sales of 29.26MU and energy requirement/purchase from KSEB as 29.37 MU. Accordingly the T&D loss approved was 0.37%. As against this, the actual loss level reported by the licensee is 0.33% as shown below. For the purpose of truing up the actual loss level reported by the licensee is accepted.

Particulars	2006-07		
	Approved	Actual	Truing up
Energy sales (MU)	29.26	33.23	33.23
Distribution losses (%)	0.37%	0.33%	0.33%
Energy Requirements (MU)	29.37	33.34	33.34

6. Based on projections of the licensee the Commission has approved loss level of 0.39% for 2007-08 and 0.74% in 2008-09. However the actual loss level of loss for these two years were in fact negative. The Commission sought clarification on the negative losses. CSEZ in its reply dated 4-8-2010 and 22-8-2010 stated that the mismatch observed between the meter readings of purchase and sale of energy was taken up with KSEB and the officers of KSEB had inspected the installation and conducted tests during May 2010. The final report on the same is yet to be received. The CSEZ had also tested all the HT metering system, which is in the final stage. According to the licensee the excess financial gain is Rs.17.79 lakhs for 2007-08 and Rs.39.60 lakhs for 2008-09. The licensee has also ensured that after ascertaining the details and reason for energy loss, if the consumers were over charged, the same can be returned promptly. The licensee shall submit a compliance report on the matter to the Commission in due course. Till then they have requested to accept the figures as presented. The Commission has accepted the explanation of the licensee and for the time being adopted the actuals reported by the Licensee for the purpose of truing up. Accordingly, the energy sales and power purchase for 2007-08 to 2009-10 is approved as follows.

Particulars	2007-08		2008-09		2009-10	
	Approved	Actual	Approved	Actual	Approved	Actual
Energy sales (MU)	35.81	44.12	47.99	43.32	52.80	44.24
Distribution losses (%)	0.39%	-1.36%	0.74%	-3.14%	0.71%	-2.15%
Energy Requirements (MU)	35.95	43.53	48.35	42.00	53.18	43.31

Power purchase:

7. The power purchase approved by the Commission for the three years is as follows:

Year	Power purchase cost (Rs.lakh)		
	Approved	Actual	True Up
2006-07	925.80	1,043.06	1,043.06
2007-08	1,110.18	1,379.49	1,379.49
2008-09	1,526.50	1,390.02	1,390.02
2009-10	1679.12	1451.95	1451.95

The licensee has explained that the reason for variations in the actual cost compared to the approved figures in energy purchase is due to changes in the energy sales. While reporting the power purchase cost for 2008-09, the CSEZ

has excluded fuel surcharge and additional charges for excess consumption since the same was collected from the consumers and transferred to KSEB. However, for the year 2009-10, the power purchase includes the charges for excess consumption over quota. The Commission accepts the actual power purchase cost reported by CSEZ for truing up.

Employee costs:

8. The licensee has outsourced the complete operation and maintenance of power distribution system . Accordingly the contractor provides the manpower required for operation and maintenance. A small portion of the costs of CSEZ employees is also charged under the employee costs. During the clarification meeting, the Commission sought the details for apportioning of costs. As per the details provided by CSEZ, the employee cost has two components viz., the management charges paid to the contractor for operational staff and the cost of secretarial/ministerial services extended from CSEZ employees. The actual O&M expenses for outsourced job was Rs.46.02 lakhs for 2006-07, Rs.50.69 lakhs for 2007-08 and Rs.59.29 lakhs for 2008-09. The share of CSEZ staff was based on a proportional allocation of about 10% of the salary, which was worked out for 2006-07. This has been escalated at 10% for next two years. Accordingly the share would be Rs.8.89 lakhs and Rs.9.77 lakhs for 2007-08 and 2008-09. However, for 2008-09 a provision of only Rs.6.53 lakh was made considering the increase in the cost of outsourced component. In 2009-10, no provision was included.
9. The Commission notes the clarification provided by M/s CSEZ on employee costs. It has been clarified that the o&M works are outsourced to M/s Kitco. The agency was assigned the work on a year to year basis and the escalation was provided on mutually settled terms. There has been about 40% increase in employee costs in 2009-10. There is no justification provided for such large increase. The Commission is not in agreement with the present method of selecting the O&M agency. The selection has to be through transparent competitive tendering process. With this observation, the Commission for the purpose of truing up approves the employee costs actually incurred for the outsourcing of operations. The Commission notes the arbitrariness of allocation of employee costs of CSEZ in the distribution business. The Commission in principle agrees to provide a portion of CSEZ employee costs to be part of the distribution. Accordingly the share of costs proposed by CSEZ is approved for the truing up. However in future, present arbitrary method has to be done away

with. The Commission has already initiated a detailed study to ascertain the reasonable level of joint costs to be assigned to the distribution business. The employee costs approved for the truing up is as follows:

Year	Employee cost (Rs.lakh.)		
	Approved	Actual	True Up
2006-07	55.22	54.10	54.10
2007-08	60.74	59.58	59.58
2008-09	55.98	65.82	65.82
2009-10	61.58	91.54	91.54

R&M expenses

10. CSEZ has included the cost of spares for maintenance and the electricity charges for distribution auxiliaries and lighting under the R&M expenses. The power consumption is completely metered and notionally LT industrial tariff is applied for arriving at the electricity charges. Since the maintenance works are completely outsourced and the charges are part of the employee costs, only cost of spares are booked as part of R&M expenses. The R&M expenses for 2006-07, 2008-09 and 2009-10 were higher than the approved level. The licensee clarified that only the actual cost of spares which were used for maintenance were included under this head. The Commission approves the R&M expenses booked by the licensee for the purpose of truing up.

Year	R&M expenses (Rs.Lakh)		
	Approved	Actual	True Up
2006-07	6.00	7.39	7.39
2007-08	7.48	4.27	4.27
2008-09	8.23	10.55	10.55
2009-10	9.05	9.80	9.80

A&G Expenses

11. The major item booked under the A&G expenses is insurance. However, the licensee has stated during the clarification meeting that as per rules of Government of India, Government properties are not insured and the insurance is only a provision given and actually the expenditure has not incurred. Similarly the technical fee given in the accounts is also a provision which has not been incurred. Under the head Rent and taxes, a provision is made for lease rent for land occupied for power systems which is payable to the Government, but not

incurred yet. Other items such as telephone expenses are claimed at actuals for the distribution business. The payment of fees to the Commission and electrical inspectorate fees are included under fees and subscriptions. The CSEZ has clarified that, insurance and technical fee (amounting to Rs.12.73 lakh) are not paid and only provision was made in the accounts. Since the amount is not incurred and there is no likelihood of charging insurance and technical fee for the previous years, this amount is deducted from the A&G expenses. As and when CESZ becomes an Authority notified under the SEZ Act, the insurance can be provided for the assets. In 2009-10, the licensee has not included the insurance and technical fee, and there is substantial reduction in fees and subscriptions. The Commission considers the explanation given by the licensee and approves the A&G expenses for the purpose of truing up as follows:

Year	A&G expenses (Rs.Lakh)			
	Approved	Actual	True Up	
			Less provisions	Allowed
2006-07	30.16	29.53	(12.73)	16.80
2007-08	31.45	29.75	(12.73)	17.02
2008-09	33.21	29.81	(12.73)	17.08
2009-10	35.01	11.47	-	11.47

Depreciation:

12. The depreciation is claimed as per the CERC norm. The total addition to the Gross fixed assets and the depreciation claimed for the three years is as follows:

		Substations	11kV Works	Metering equipments	Total
Gross Fixed Assets (Rs.lakh)	2006-07	482.98	475.05	60.10	1,018.13
	2007-08	482.98	496.79	68.60	1,048.37
	2008-09	482.98	496.79	74.89	1,054.66
	2009-10	482.98	496.79	78.07	1,058.02
Depreciation (Rs.lakh)	2006-07	17.38	17.10	3.61	38.09
	2007-08	17.38	17.88	4.12	39.38
	2008-09	17.38	17.88	4.49	39.75
	2009-10	17.39	17.88	4.66	39.93
Average rate of depreciation		3.60%	3.60%	5.97%	3.77%

The addition to assets was marginal in the four years under consideration. Asset addition was mainly under the metering equipments. The licensee clarified during the meeting held on 20-11-2010 that all the assets in the Zone was

developed using grants from Government of India. As per the established regulatory principles, depreciation on assets created out of grants are to be excluded from allowable expenses unless the replacement of capital assets are segregated from routine capital additions. The Commission has formulated a policy on claiming depreciation on the assets made out of grants and contribution. As per the policy, the depreciation on contribution shall not be claimed from the consumers, unless the replacement of assets is done using the same amount. The Commission is also aware of the limited nature of operations of the licensee and the easy possibility of separating capital expenses created out of depreciation funds. Accordingly the depreciation booked of *Rs.157.15 lakhs* for the years 2006-07 to 2009-10 shall be kept separately in a fund and shall be utilised for additional capital expenditure/replacement of assets created out of grants with the approval of the Commission. The utilisation of the fund can be taken up along with each ARR&ERC exercise with proper capital expenditure programme. The Commission provisionally allows the claim of depreciation in the truing up.

Interest and financing charges:

13. The licensee stated that the total investment made for the distribution assets are part of the grants received from the Government. Hence there is no interest charges booked for the distribution business.

Interest and expenses capitalised

14. The licensee has not booked any item under this head

Return on equity

15. The licensee has not booked any equity in the books and also not claimed any return. CESZ has stated that, Government has decided to establish CSEZ as a separate authority as per the CESZ Act. In such a situation, the operations of the zone will be completely independent and autonomous. The Commission feels that, as a separate entity, the licensee may have to carryout financial operations independently. At present no surplus is allowed to CSEZ and considering the requirement of future operations, the Commission decides that a token amount of Rs.10 lakhs per year from the surplus can be transferred to reserves.

Non tariff Income

16. As per the licensee, the revenue claimed under this head is the interest received on the security deposit held by KSEB. The interest was paid only during 2006-

07. The licensee claimed that, the Government of India advanced the funds for payment of security deposits to KSEB and the same is not included as part of the capital expenditure. Hence, the interest earned should be transferred to the Government. As per the accrual system of accounting, the interest to be receivable should be booked in the books as and when it is due. The Commission is of the view that the licensee shall take up the matter with KSEB. The Commission approves the non-tariff income as per the actuals.

Revenue from tariff

17. The licensee has stated that all the income received is booked under this head, which includes, reconnection fee, meter rent etc. The difference between the approved and actual expenses is on account of actual difference in sales. After considering the details submitted by the licensee, the Commission approves the income from tariff as shown by the licensee for the three years for the purpose of truing up. The Licensee is also directed to ensure that energy consumption for own use as well as common purposes are to be metered, billed and reflected in the accounts.

Aggregate Revenue Requirements and Revenue surplus after truing up

18. The revenue surplus reported by the licensee for the year 2006-07 was Rs.154.80 lakhs. The revenue surplus arrived at after the truing up exercise for the year 2006-07 is as follows:

Particulars	2006-07		
	Approved (Rs. lakh.)	Actual (Rs. lakh.)	Truing up (Rs. lakh.)
Power purchase cost	925.80	1,043.06	1043.06
Interest & financing charges	-	-	--
Depreciation	38.11	39.39	39.39
Employee cost	55.22	54.10	54.10
R&M Expenses	6.00	7.39	7.39
A&G expenses	30.16	29.53	16.80
Total Expenses	1,055.29	1,173.47	1160.74
Less Other income	16.00	7.24	7.24
Net Aggregate Revenue Requirements	1,039.29	1,166.23	1153.50
Revenue From tariff	1,175.55	1,321.03	1321.03
Net Surplus/(Gap)	136.26	154.80	167.53

The revenue surplus reported by the licensee for the year 2007-08 was Rs.211.12 lakhs. The revenue surplus arrived after the truing up exercise for the year 2006-07 is as follows:

Particulars	2007-08		
	Approved	Actual	Truing up
	(Rs. lakh.)	(Rs. lakh.)	(Rs. lakh.)
Power purchase cost	1,110.18	1,379.49	1379.49
Interest & financing charges	-	-	-
Depreciation	38.11	39.77	39.77
Employee cost	60.74	59.58	59.58
R&M Expenses	7.48	4.27	4.27
A&G expenses	31.45	29.75	17.02
Total Expenses	1,247.96	1,512.86	1500.13
Less Other income	16.00	-	--
Net Aggregate Revenue Requirements	1,231.96	1,512.86	1500.13
Revenue From tariff	1,434.60	1,723.98	1723.98
Net Surplus/(Gap)	202.64	211.12	223.85

The revenue surplus reported by the licensee for the year 2008-09 was Rs.178.66 lakh. The revenue surplus arrived after the truing up exercise for the year 2008-09 is as follows:

Particulars	2008-09		
	Approved	Actual	Truing up
	(Rs. lakh.)	(Rs. lakh.)	(Rs. lakh.)
Power purchase cost	1,526.50	1,390.02	1390.02
Interest & financing charges	-	-	-
Depreciation	39.40	39.77	39.77
Employee cost	55.98	65.82	65.82
R&M Expenses	8.23	10.55	10.55
A&G expenses	33.21	29.81	17.08
Total Expenses	1,663.32	1,535.97	1523.24
Less Other income	18.00	-	--
Net Aggregate Revenue Requirements	1,645.32	1,535.97	1523.24
Revenue From tariff	1,886.18	1,714.63	1714.63
Net Surplus/(Gap)	240.86	178.66	191.39

The revenue surplus reported by the licensee for the year 2009-10 was Rs.288.79 lakh. The revenue surplus arrived after the truing up exercise for the year 2009-10 is as follows:

Particulars	2009-10		
	Approved	Actual	Truing up
	Rs.lakhs	Rs.lakhs	Rs.lakhs
Power purchase cost	1,679.12	1,451.95	1,451.95
Interest & financing charges			
Depreciation	39.40	39.94	39.94
Employee cost	61.58	91.54	91.54
R&M Expenses	9.05	9.80	9.80
A&G expenses	35.02	11.47	11.47
Total Expenses	1,824.17	1,604.70	1,604.70
Less Other income	20.00	96.46	96.46
Net Aggregate Revenue Requirements	1,804.17	1,508.24	1,508.24
Revenue From tariff	2,074.79	1,797.03	1,797.03
Net Surplus/(Gap)	270.62	288.79	288.79

The total surplus after truing up for the 2006-07, 2007-08, 2008-09 and 2009-10 is as follows:

Year	Revenue Surplus (Rs.Lakh.)				
	Approved	Actual	True Up		
			Surplus	Less transferred to reserve	Net Surplus
2006-07	136.26	154.80	167.53	10.00	157.53
2007-08	202.64	211.12	223.85	10.00	213.85
2008-09	240.86	178.66	191.39	10.00	181.39
2009-10	270.62	288.79	288.79	10.00	278.79
Total	850.38	833.37	871.56	40.00	831.56

19. The total revenue surplus after the true up is Rs.871.56 lakh. The CSEZ in its clarification stated that the accumulated surplus over the years is about Rs.5 crore. Out of this amount the licensee has proposed to carryout capital expenditure of Rs.4.10 crore as follows:

1. LED Street lighting , SPV systems - Rs.290.25 lakh
2. SCADA in Substation - Rs. 60.00 lakh
3. Web enabled data access system - Rs. 60.00 lakh

20. The Commission notes that the licensee has not sought the approval of the Commission for the capital expenditure. Prima facie, expenditure incurred for

street lighting systems shall not be part of the capital expenditure of the Licensee. The Commission hereby directs that formal approval for the capital expenditure programme has to be obtained by providing all details to the Commission. In its absence, the expenditure shall not be allowed as part of the ARR. In the absence of formal approval process, the Commission is not in a position to accept the arguments of the licensee on the utilisation of surplus earned. The surplus of Rs.831.56 lakhs arrived at as part of the present truing up process shall be separately held and the same can be utilised only with the approval of the Commission. The Licensee may utilise the fund for meeting the additional expenses on account of increase in BST with the advance approval of the Commission.

Order of the Commission

21. The Commission after considering the the truing up petitions for the years 2006-07 to 2009-10 filed by the licensee M/s CSEZ, objections there of, and the clarifications and details provided by the licensee, has arrived at revenue surplus of Rs.831.56 lakhs. The licensee shall comply with the following directions.

- a) The licensee shall separate the accounts of distribution business and year end auditing shall be conducted periodically.
- b) For the purpose of truing up audited accounts for the distribution licence along with audited account of CSEZ shall be provided
- c) The licensee shall create a fund for remitting Rs.157.15 lakhs already claimed as depreciation for the years from 2006-07 to 2009-10. The utilisation of the fund shall be for replacement of capital assets and for creation of fixed assets as approved by the Commission.
- d) The surplus of Rs.831.56 lakhs arrived after the truing up for years 2006-07 to 2009-10 shall be kept in a separately in a fund, which shall be utilised with the approval of the Commission

With the above, all petitions are disposed of. Ordered accordingly.

Sd/-
P.Parameswaran
Member

Sd/-
Mathew George
Member

Sd/-
K.J.Mathew
Chairman

Approved for Issue

Secretary