

MANDI GOBINDGARH INDUCTION FURNACE ASSOCIATION (REGD.)

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BEFORE THE PUNJAB STATE ELECTRICITY REGULATORY COMMISSION

FILE NO.

CASE NO.

IN THE MATTER OF:

ANNUAL REVENUE REQUIREMENT & TARIFF APPLICATION FOR TRUE UP
FY2020-21, APR/RE FOR FY 2021-22 AND PROJECTIONS FOR FY2022-23

Punjab State Electricity Regulatory Commission (PSERC) has invited objections/ comments from the Industry and other consumers on the ARR submitted by PSPCL and PSTCL.

MandiGobindgarh Induction Furnace Association has already submitted its comments on the ARR of PSPCL for the year 2022-23. We were to attend the Public Hearing on 17.2.2022 but could not do so due to preoccupation with other pressing matters.

MandiGobindgarh Induction Furnace Association submits had prepared a note on Equity and Return on Equity claimed by both the Licensees for submission during Public hearing held on 17.2.2022 and the same are submitted as under.

Submissions on Equity and Return on Equity

Our submissions on the issue of Equity and Return on Equity of PSPCL and PSTCL are as under:-

1. The then Punjab State Electricity Board was constituted under Electricity (Supply) Act 1948 as per which PSPB was to finance all its Capital works through Loans only and was required to recover the interest payable on loan (Interest and Finance Charges) and installments to repay loan (Depreciation) through Tariff. A major part of financing was through state government loans and to escape the liability of interest payable to GOP, PSEB got the loan converted into equity of GOP in PSEB as increase in tariff being controlled by GOP was quite inadequate to cover the expenses of PSEB. PSEB never paid

any interest on such loan as well as installment of loan converted into equity or Return on such converted equity.

2. PSERC issued first tariff order for the year 2002-03 which provided for equity and return on equity as under:- .

6.10. EQUITY AND RETURN ON EQUITY

The Government of Punjab has declared the PSEB as a body corporate with a Capital of Rs. 5 crores with effect from 10th March 1987 under Section 12A of Electricity (Supply) Act 1948 and converted Rs. 1612 crores representing Government loans granted upto 3/90 into equity during 1991-92 and Rs.1189.11 crores representing 50% of loans granted during 1990-91 to 1994-95 in 1996-97. The total State Government Equity in PSEB is Rs.2806.11 Crores.

Further no ROE was allowed in the tariff Order 2002-03 and after till 2005-06 by this Hon'ble Commission under Electricity Regulatory Commissions Act, 1998 and Electricity (Supply) Act 1948 and only 3% Return on Net Fixed Assets were allowed.

3. Evidently, the equity shown then was also loans camouflaged as Equity to get higher returns. Initial equity of Rs. 2946.11 crore of Punjab State Electricity Board, which became equity of PSPCL and PSTCL is also nothing but government loans, which was got converted into equity on different occasions by the then PSEB management(s) to reduce loan liability in its Books and to escape liability of payment of Interest on such loans and loan installments to insulate consumers from increase in tariff prior to setting up of Regulatory regime. Return on Equity of Rs 412.46 Cr per year was allowed only from 2006-07 onwards on Equity of Rs 2946.11 Cr as per Para 4.15 of TO.
4. While there is no objection on such conversion for accounting purpose but for fixing tariff, apparently, there is no differentiation between loans given by Government of Punjab to Board/PSPCL and equity. In fact, all the assets of PSEB/PSPCL/PSTCL were/are created by borrowing and a part of it shown as equity of Board. This evidently has been done to help Discom to reduce its interest burden as no ROE/dividend is payable to Government of Punjab till PSEB/PSPCL incurs losses. Thus a methodology devised to keep the tariffs on lower side is now being used to increase income of PSPCL by unduly loading the consumers and meeting the losses due to inefficient working of PSPCL. Consequently, the consumers of the State are burdened with the higher tariff and

financial loss in the form of 15%-16% Return on Equity on such amount, which is in fact a government loan on which not more than 7-8% interest needs to be allowed.

5. PSEB was bifurcated into PSPCL and PSTCL on 16.4.2010 and as per provisional FRP/Transfer scheme, and Equity of PSEB of Rs 2946.11 Cr was also divided between them as Rs 2617.61 Cr and 328.50 Cr and ROE was allowed separately as Rs 366.47 Cr and Rs 45.99 Cr for PSPCL and PSTCL respectively.
6. Subsequently, FRP and Transfer scheme was finalized and notified on 24.12.2012 by GOP. In this notification, an amount of Rs.3132.35 crore standing in the books of PSEB on 15.4.2010 under the head "Consumer Contributions & Govt Grants" and some other amounts was also converted into equity of GOP and the same was admitted by PSERC as well. Thus the equity of PSPCL was enhanced from Rs 2617.61 Cr to 6081.43 Cr (Para 3.16 of TO 2013-14) and of PSTCL from 328.50 Cr to Rs 605.83 Cr. (Para 3.10 of TO 2013-14). Thus the total equity was increased from 2946.11 Cr to 6687.26 cr.
7. The conversion of Consumer Contribution and Govt Grants/subsidies was appealed by consumers in APTEL and APTEL directed PSERC to reconsider the issue vide judgment Dated 17-12-2014 in Appeal No 168 and 142 of 2013 as under:-

"48. ----- We direct the State Commission to adjust the excess amount of ROE in the impugned order from the FY 2011-12 onwards in the ARR/ True up for the year to provide relief to the consumers."

"Issue No. (iii) Relating to Return on Equity, Consumers Contributions, Grants, Subsidies etc.

50.3 The findings of this Tribunal in Appeal no. 46 of 2014 shall squarely apply to the present case. The State Commission shall re-determine the ROE as per our directions and the excess amount allowed to the distribution licensee with carrying cost shall be adjusted in the next ARR of the respondent no.2.
8. APTEL observed that the Govt can hold any amount as equity in PSPCL and PSTCL but ROE needs to be granted only on actually subscribed and paid up equity only i.e. cash money which has been infused need to be counted as equity for the purpose of ROE. PSPCL has filed an Appeal against the order in Supreme Court and stay has been

granted. Final order of SC is still awaited. However, because of Stay granted by The Supreme Court, PSERC is granting ROE on Rs 6081.43 Cr to PSPCL and 605.88 Cr to PSTCL.

9. The CAG also objected to the conversion of non-interest bearing consumer contribution and Govt grants/subsidies etc into equity.
10. Subsequently, MOP, GOI introduced UDAY scheme for stressed power sector and PSPCL, GOP and MOP entered into a tripartite agreement as per which PSPCL loans of Rs 15628.26 Cr were to be taken over by GOP through issue of SLR bonds by banks in the name of GOP and loans were to be taken off the books of PSPCL. UDAY scheme was up to 31.3.2020 and PSPCL proposed in previous year's ARR 2020-21 to convert the loan amount of Rs 15628.26 Cr as GOP equity in PSPCL thereby increasing GOP equity from 6081.43 cr to 21709.69 cr. It was also proposed to recover ROE on this loan converted equity amount of Rs 15628.26 @ 15.90% which works out to Rs 2485 Cr in addition to Return on Equity on Rs 6081.42 crore. Thus by simply maneuvering the entry of loan amount to equity, consumers were to be asked to pay 3423 Cr. This is clearly against the interest of the consumers. However, as per the Tariff order dated 28th May 2021 passed by this Hon'ble Commission, claim of such return on equity was rejected by the Commission and ROE was kept the same at Rs.974.74 crore on equity of Rs. 6081.43 crore for FY 2020-21.
11. Instead of agreeing to the decision of the Commission and knowing fully well that the equity amount being not a cash flow does not qualify to be equity for ROE purpose, and being aware of the fact that APTEL has already rejected PSPCL's previous similar attempt and an audit para in this regard is already raised by CAG, Now in current ARR for FY 2022-23 dated 30th November 2021, PSPCL has come out with an entirely new argument for claiming increased equity and higher amount as Return on Equity. It is claimed that out of Rs.15628.26 crore, Rs.2246.77 crore were spent on capital expenditure and 13381.49 crore were working capital loan, out of which Rs.2346.19 crore were also diverted towards capital expenditure. As per PSPCL, taking together, Rs.4592 crore should be treated as equity and return on equity should be now allowed on Rs. 10674 crore (Rs.6081.43 crore + Rs.4592 crore). PSERC and APTEL have amply made clear that

only cash flow is to be treated as equity for the purpose of ROE, MYT regulations provide that equity should be actually infused for creation of useful assets. Therefore, there is no case for allowing Return on Equity beyond Rs.6081.43 crore, which in principle is also under litigation, on which APTEL has decided adversely and matter is in Supreme Court. It is also pertinent to mention that all the assets considered for supply of electricity to the consumers of the States as admitted by PSERC are already accounted for and linked with corresponding source of funding through debts. Hence, there is apparently no case for allowing return on equity beyond the admitted amount of equity.

12. It is pertinent to state here that PSPCL submitted the effect of UDAY scheme on the ARR of 2016-17 vide its letter no 481/CC/DTR/Dy CAO/245/Vol 1 dated 12.4.2016 which clearly states that whole of the amount taken over by GOP under UDAY scheme comprises of debt. Further, the tripartite agreement executed under UDAY scheme provided that 75% of the amount taken over by GOP will be converted into grant of GOP to PSPCL at the close of the scheme. Further, GOP was to compensate the loss of PSPCL in a graded manner during the period 2017-18 to 2020-21. However, so far neither any grant has been given by GOP in terms of UDAY tripartite agreement nor any loss compensation has been given/shown in ARR. Thus, PSPCL has failed to get any relief in the form of Grant of 75% of debt or compensation for the losses which would have given relief to the consumers in the shape of lower tariffs but has acted proactively to convert whole of the loan of GOP into equity and claim ROE for the same to load the consumers through higher tariff. The demand needs to be rejected out rightly.
13. It is evident that in violation of the UDAY Scheme resolution, the amount of debt of Rs.15628 crore was converted into equity by PSPCL. As such, return on such debts has been artificially increased by showing it as equity and return sought is almost double as Regulations provide for return on equity @15-16% assuming 70:30 ratio of debt and equity. Even in such case, the amount of equity is to be kept at actual or 30% whichever is lower. Hence, it is the basic tenet that higher return should not be given on equity, when it is not infused in cash and debt should not be proposed by PSPCL / allowed by PSERC to be camouflaged as equity with the sole aim of claiming higher return.

14. It is also highlighted here that as per PSPCL's own admission, the assets created by PSPCL as well as erstwhile Electricity Board/Electricity branch of PWD through debt/loan, consumer contributions and Govt grants etc and not through any infusion of cash equity, there is need to investigate the source of funding of assets created by Discom/Board.

15. It is pertinent to note that PSPCL has itself admitted that gross fixed assets of GNDTP were created through loans and no infusion of equity was made at any stage. (*Reference para 2.20, page 56-57, Tariff Order dated 28th May 2021*). The relevant part is reproduced below

"The Commission has considered project-wise RoE based on the RoE approved in True-up of FY 2017-18. As PSPCL did not submit project-wise/ plant-wise equity during the True-up of FY 2017-18, the allocation was done based on GFA. Further, PSPCL had submitted project report of GNDTP in which it is mentioned that there had been no infusion of equity in GFA of GNDTP and the same was financed completely through loans."

16. The consumer contribution and Govt grants, which have been shown as part of equity (Rs.3135.32 crore) is also not equity in any sense and the same should be reduced from the equity and taken back to consumer contribution or to be written off for ARR purpose and no return on equity to be allowed on the same. In this regard, MYT regulations of PSERC and APTEL decision should be relied upon-when no tangible benefits are given to consumers through equity infusion, the same cannot be burdened with higher interest cost in the garb of return on equity.

17. PSPCL has claimed Rs.15628 crore as equity for previous years and this year, out of it Rs.4592 crore is claimed as additional equity over and above of Rs.6081.43 crore and return on equity is claimed on the same for FY 2021-22 and FY 2022-23. Tomorrow, if PSPCL raised loans from some sources, invest and create some capital assets and show the same as equity instead of loan for ARR purpose, how commission would approach the same?

18. In the light of above facts, it becomes obvious that PSPCL has been trying to show higher and higher amount of funds raised through loans as equity to claim higher return on the same in the form of return on equity @15%-16%, which is about 7-8% higher than normal interest loan i.e almost double benefit for PSPCL. While the matter of fact is that all funds invested for capacity creation for supply of power are borrowed funds on which only normal interest is to be paid. The methodology being adopted by PSPCL has been resulting into higher cost of supply year after year, which need to be looked into.

19. Such a view become quintessential in the light of observations made in the **REPORT OF THE FORUM OF REGULATORS ON "ANALYSIS OF FACTORS IMPACTING RETAIL TARIFF AND MEASURES TO ADDRESS THEM" (2020)**. Incidentally, ex Chairperson, PSERC happened to be chairperson of the Committee which prepared the above said report and Staff of this Hon'ble Commission may be aware of the same. The report analyzes the mechanism of the tariff fixation in detail and need for bringing modifications to make it more relevant and reduce the power tariff in different states. In para 2.1.3 of the report, which deals with fixed cost related factors, it is mentioned that

"A comparison of the RoE allowed by different States for generation, transmission and distribution revealed that the post-tax RoE has been in the range of 14% - 16%. An analysis was also made regarding the prevailing cost of debt and it was found that the lending rate has been on the low side for quite some time. While the RoE has an element of risk premium, the data analysis revealed the need for reconsidering the RoE keeping in view the prevailing prime lending rate and 10 - year G-Sec rate.

20. On return on equity, following observations have been made on page 22 of the report in para 4.1.1, which is reproduced below:

4.1.1. Return on equity allowed to Generation/ Transmission and distribution companies need to be made more realistic and at par with interest rates.

- ☐ *RoE for generation and transmission should be linked to the 10 year G Sec rate (average rate for the previous 5 years) plus risk premium subject to a cap as may be decided by appropriate Commission.*

- ❑ For a discom, the RoE could be fixed based on the risk premium assessed by the State Commission. Income tax reimbursements should be limited to the RoE component only.
- ❑ Performance of Distribution licensees has a significant impact on retail tariff for the consumers. Therefore, there is a need to link recovery of RoE with the performance of the utilities, based on the indicators such as supply availability, network availability, AT&C loss reduction".

Prayer

In the light of above observations, it is necessary that return on equity need to be reduced drastically from the present level of 15%-16% to average long term rate of interest on government borrowings (to about 7-8%), linking it with return on government security for 10 years or more.

Yours faithfully,

(PRESIDENT)

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