Before the

MAHARASHTRA ELECTRICITY REGULATORY COMMISSION

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CASE No. 18 of 2003

In the matter of Determination of Tariff of M/s. BSES Ltd.� (now Reliance Energy Ltd.) -

Review of Cap on monthly recovery of FAC charges.

Dr Pramod Deo, Chairman,

Shri A. Velayutham, Member

ORDER

Dated: 13th April, 2005.

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In its Order dated 1st July, 2004 determining the tariff of M/s. Reliance Energy Ltd. (REL), the Commission, while setting out the formula for Fuel Adjustment Cost (FAC) charges, had observed that:

�*The change in variable cost of own generation and variable cost of power purchase should be considered in FAC computations, subject to operational norms, i.e. Generation, Heat Rate and Auxiliary Consumption approved by the Commission for DTPS, and the generation and power purchase mix in line with the principles approved by the Commission in the Order*.��

The Commission has also stipulated that-

�*The total FAC recoverable, as per the formula discussed above, should be recovered from the actual sales in that period in Rs/kWh terms. If the T&D loss of BSES is higher than the T&D loss level approved by the Commission, then the amount of FAC corresponding to the excess T&D loss in units will be deducted from the total FAC recoverable.*�

������ Further, with the intention of mitigating any sudden tariff shock to consumers, the Commission had also provided that:

�*The total FAC to be charged to the consumers during any year should not exceed 10% of the variable component of tariff <u>or increase in Consumer Price Index (CPI) in a similar period, whichever is lower</u>. In case, the FAC chargeable during any month exceeds any of these limits, then the <u>Licensee</u> will carry forward the variation in costs and recover through FAC charge in the future period.*�

2.����� As directed in the Tariff Order, on 29th September, 2004, REL submitted computations of FAC charges for July, 2004 (i.e. the first month following the Order) for approval, followed subsequently by further details and clarifications.

3.����� The Commission finalized its vetting of FAC computation and conveyed its decision to REL.� Among other things, the Commission stated, under letter dated 19th January, 2005, at Clauses 4.8 and 4.9 as follows:

� " 4.8� Cap on Monthly FAC Charge

"The Commission has noted while assessing FAC Charge for June 2004 for TPC that considering these aspects, the Commission is of the view that the linkage of cap on monthly FAC Charge with increase in CPI needs to be reviewed in the case of TPC at an appropriate time after following due process in view of TPC�s particular fuel mix. Pending such review, the Commission has decided to delink the cap on

monthly FAC Charge to the increase in CPI in a similar period in respect of TPC. However, this may necessitate adjustment at a later date if the linkage of monthly FAC Charge to the increase in CPI in a similar period is upheld after the review.

Since REL meets a significant part of its requirement by power purchase from TPC, the Commission is of the view that the linkage of the cap on monthly FAC Charge with increase in CPI will need to be reviewed in the case of REL also after following due process. Pending such review, the Commission has decided to delink the cap on monthly FAC Charge to the increase in CPI in a similar period in respect of REL. However, this may necessitate adjustment at a later date if the linkage of monthly FAC Charge to the increase in CPI in a similar period is upheld after the review.

The ceiling based on 10% of the variable component of tariff works out to 29.90 Paise/kWh considering the revenue from energy charge at Rs. 1910 crore and consumption at 6381 MU for FY 2004-05 as considered in the Tariff Order. Thus, in order to avoid sudden tariff shock to consumers, the ceiling on monthly FAC Charge will be 29.90 Paise/kWh for FY 2004-05. This means that the average energy charge in any month cannot exceed 329.20 Paise/kWh (i.e. 299.30 + 29.90 Paise/kWh) for FY 2004-05.

��� 4.9� FAC charge considering monthly cap on FAC Charge

Since FAC_{kWh} *for July 2004 is lower than the monthly cap on FAC Charge as above, the FAC Charge is assessed at 3.9 Paise/kWh.*

It is also further clarified that in case the FAC amount is under recovered for any month in future due to application of the cap, such under recovered amount shall be carried forward to future period for inclusion as part of Adjustment for Over Recovery/Under Recovery component of FAC. To compensate it for additional Working Capital requirement attributable to deferred recovery of FAC due to application of monthly cap, REL shall be entitled to recover working capital interest at actuals as per the provisions of the Working Capital Interest (I) component of FAC."

������ Accordingly, the Commission initiated suo moto a formal review of the provisions of its Tariff Order dated 1st July, 2004 only to the extent of the cap on monthly FAC charge recovery related to CPI.

4.����� At the hearing held on 2nd February, 2005, Shri Prakash Beria of REL stated that, apart from the considerations mentioned in the Commission's vetting of FAC charges, local freight charges had increased considerably and were expected to rise further, and the cost of imported coal has also risen.� There was high volatility in crude oil prices.� None of these are at all or adequately captured by the CPI.� Therefore, he welcomed the Commission's decision to review the cap.� He also submitted that the other cap of 10% of variable cost may also have

to be reviewed in the context of volatile prices.� The Commission observed that the consumer would have to pay at some stage, and the issue was how to strike a balance and even out the burden appropriately, and noted REL's point regarding the variable cost cap.

5.����� The Commission notes that similar review proceedings were initiated suo moto in respect of the CPI-based cap on monthly recovery of FAC charges by TPC, and Order issued by the Commission on 4th April, 2005.

6.����� Considering the submissions made during these proceedings, the Order dated 4th April, 2005 in respect of TPC and the circumstances which became apparent while vetting REL's FAC computations as a result of which this review was initiated, it is clear that the ceiling on FAC based on CPI, which hardly captures the fuel� (more so liquid fuel) cost movement, does not benefit the consumer since he would eventually be burdened with a cumulative shock, including interest, at the end of the day, considering the present level and volatility in fuel prices and the power purchase of REL.� Thus, not only would the purpose of the cap be defeated, but REL's cash flow may also be affected, with possible impact on service standards.� Working capital interest on the delayed recovery would also be finally reflected in future tariff.�� The generation and power purchase mix largely determines the fuel cost variation, and it would be in the interest of both REL and their consumers that such variation is passed through earlier rather than accumulating.� At the same time, a balance of convenience also has to be struck in such circumstances between a tariff shock in any particular month, and an accumulated burden at the end of the day.� The Commission believes that doing away with the CPI related ceiling while retaining the other provisions in the Tariff Order, viz. of a ceiling on monthly recovery of 10% of the variable component of tariff, would be fair and equitable to both REL and their consumers, and also address the stated purpose of the ceiling on monthly FAC recovery. Therefore, in modification of the dispensation in this regard in the Commission's Tariff Order, the CPI-related cap on monthly FAC recovery is removed.� However, as at present, the total FAC to be charged to the consumers by REL during any year should not exceed 10% of the variable component of tariff. In case the FAC chargeable during any month exceeds this limit, then REL will carry forward the variation in costs and recover it through FAC charge in the future period.

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Sd/-

(A. Velayutham)

Member

Sd/-

(Pramod Deo)

Chairman, MERC

Sd/-

(A.M. Khan)

Secretary, MERC