Before the
MAHARASHTRA ELECTRICITY REGULATORY COMMISSION
13th floor, Centre No.1, World Trade Centre, Cuffe Parade, Mumbai 400 005.
Tel. 22163964 / 22163965, Fax No. 22163976
E-mail mercindia@mercindia.com
Website: www.mercindia.com

CASE No. 30 of 2003

In the matter of Determination of Tariff of M/s. Tata Power Company Ltd. - Review of Cap on monthly recovery of FAC charges.

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

ORDER

Dated: 4th April, 2005.

In its Order dated 11th June, 2004 determining the tariff of M/s. Tata Power Company Ltd. (TPC), 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. station-wise Heat Rate and Auxiliary Consumption approved by the Commission, station-wise generation including generation from hydel stations and adherence to Merit Order Despatch Principles in line with the Principles approved by the Commission in this 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 TPC 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 or increase in Consumer Price Index (CPI) in a similar period, whichever is lower. In case, the FAC chargeable during any month exceeds any of these limits, then the Licensee will carry forward the variation in costs and recover through FAC charge in the future period.*"

2. As directed in the Tariff Order, on 6th August, 2004 TPC submitted computations of FAC charges for June, 2004 (i.e. the first month following the Order) for approval. TPC were permitted to apply the FAC charge as per their computations pending vetting and final approval.

3. The Commission finalized its vetting of FAC computation and conveyed its decision. Among other things, the Commission stated, under letter dated 4th January, 2005, at Clauses 5.8 and 5.9 as follows:

"5.8 Cap on Monthly FAC Charge

As regards the FAC billed by TPC for June 2004, REL had separately submitted to the Commission that, considering the increase in CPI for the period from May 2004 to June 2004 at 1%, the FAC charged by TPC at 27 Paise/kWh is high. REL has requested the Commission to issue appropriate directions to TPC in this regard.

While setting the limit on FAC Charge, the Commission had not envisaged that the ceiling on FAC Charge would be reached in the first month after the issue of the Tariff Order. The high FAC is attributable to the increase in fuel cost due to high volatility of market driven imported fuel prices considering TPC's fuel mix. While reviewing the ceiling based on CPI in a similar period, the Commission is of the view that the increase in CPI does not fully capture the impact of change in cost of imported fuels such as coal and oil and thereby can deprive certain dependent Licensees of cash for meeting their prudent expenditure. Any deferment of recovery of FAC Charge for a particular month may involve an additional expenditure towards working capital requirements, if a Licensee is required to avail of it as a result. Thus, deferment of recovery of FAC Charge may also eventually result in increasing the effective tariff to consumers. 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.

5.8 FAC charge considering monthly cap on FAC Charge

Since FAC kWh for June 2004 is higher than the above monthly ceiling on FAC charge, the FAC charge is capped at 20.7 Paise/kWh. The FAC amount under-recovered for the month attributable to application of the cap shall be carried forward to future period for inclusion as part of Adjustment for Over Recovery/ Under Recovery component of FAC (A). To compensate for the additional Working Capital requirement attributable to deferred recovery of FAC (A) due to application of the monthly cap, the TPC shall be entitled to recover working capital interest at actuals as per the provision of the Working Capital Interest (I) component of FAC (A)."

Accordingly, the Commission initiated suo moto a formal review of the provisions of its Tariff Order dated 11th June, 2004 to the extent of the cap on monthly FAC charge recovery related to CPI.

4. At the hearing held on 25th January, 2005, Shri Mahesh Bhandari of TPC submitted that in light of the present dynamics in the oil market, a cap on FAC would not serve the intended purpose, and pointed out that international fuel prices are again showing an increasing trend. The increase has to be passed on quickly to consumers, since deffering it would only add to the cumulative burden they would have to bear as and when it is finally passed on. Moreover, linking the cap to CPI is not appropriate since fuel is a very small component of CPI.

5. TPC also urged that, if some cap is still be retained keeping the consumers' interest in mind, then the present 10% should be charged on the total cost and not only on the variable cost as is the case now. The cap should also include a mechanism whereby the Commission would immediately deal with the deficit on reaching the cap, in order to avoid its accumulation which would finally impact heavily on the consumers, along with interest.

6. TPC suggested that one option was to set the cap at 20% (instead of the present 10%) to allow more legroom to a licensee such as TPC, which is exposed to international oil market volatility due to its oil based generation mix. However, if the figure of 10% satisfied a sort of psychological barrier on the part of consumers, it would be preferable to fix the ceiling as 10% of the total cost rather than the variable cost. TPC representatives submitted that, in any case, few bulk or even retail consumers actually look at the bill and analyse the detailed components of the charges that they are paying. If tariff shock is the only issue, then the cap should be on the total cost.

7. Dr S.L. Patil of Thane Belapur Industries Association (TBIA) submitted that a cap on monthly FAC recovery is necessary, particularly since the inflation rate has come down to a steady level of 6% at present. Many of the ARR components processed by the Commission incorporate this inflation rate, as a result of which the licensee may gain somewhere and lose elsewhere, for which it has the opportunity to revert to the Commission subsequently. However, it is necessary to protect the consumers at any point of time, or else they would always be at the losing end. To buttress his point, he pointed to MSEB's recent FOCA recovery, which had risen from 3 paise to 25 paise. He differed with TPC's statement that consumers are concerned only with the total charges and do not go into the components of their bill. The Commission mentioned for Dr Patil's information that the sudden increase in MSEB's case was largely on account of allowing other charges through the approved formula applicable to MSEB, and the recent recovery of statutory DA expenses allowed on a provisional basis. In the case of TPC and REL, the formula laid down in the Tariff Order does not provide for such other charges, considering Section 62(4) of the Electricity Act, 2003.

8. TPC representatives reiterated that the consumer has to bear the pass through (cost plus) in any case, and with interest if it is deferred. However, the ultimate burden would be cumulative. Therefore, the consumer would not be a loser either way. However, deferral would only impede the cash flow position of the licensee.

9. The Commission asked TPC to file their written submission regarding the issues involved, along with alternative options relating to the ceiling on monthly recovery of FAC within a week's time, on which the four authorized consumer representatives could submit their comments within another week.

10. TPC have submitted their say on 31st January, 2005, suggesting alternatives as follows:

(i) **<u>Variation linked to CPI</u>**

TPC have submitted that the variation in fuel prices cannot be captured through variations in CPI since the CPI is calculated based on a large basket of items. If the variation in CPI were used as a ceiling, the FAC for June 2004 would have been restricted to 3 paise/kwh, as against 23 paise/kwh if no cap is considered, and would result in a cumulative tariff shock in future.

(ii) **Cap of 10% of Variable Charges**

With regard to the other existing cap of 10% of variable costs, TPC submitted that this also results in the FAC not being fully recovered, and leads to accumulation of un-recovered FAC. Since the un-recovered amount has to be adjusted at the end of the year, the low limit of 10% may lead to a tariff shock in the last month. Even Public Utilities are being compelled to increase their prices to consumers to meet the additional costs in the present circumstances of input cost volatility, particularly in the international markets. Therefore, alternatively, the existing 10% cap may be increased suitably, say to 20%.

(iii) TPC have also made the following suggestions:

- The tariff should be stated as the sum total of MD charges/Fixed charges and Energy charges, and the ceiling of 10% on FAC may be based on the total tariff and not on the variable charge alone.
- A limit on the un-recovered amount should be stipulated. When the un-recovered amount exceeds the specified limit, TPC should be permitted to recover it through monthly FAC charge without any ceiling.

No comments have been received from the consumer representatives.

11. Considering the various submissions made during these proceedings, and the circumstances which became apparent while vetting TPC'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 TPC's fuel mix. Thus, not only would the purpose of the cap be defeated, but TPC's cash flow may also be adversely affected, with possible impact on service standards. Working capital interest on the delayed recovery would also be finally reflected in future tariff. The generation mix available to the licensee largely determines the fuel cost variation. In TPC's case, the load centre based plant at Mumbai is oriented to liquid fuel, which is subject to international oil price movements, as a result of various operational and environmental constraints. Therefore, it would be in the interest of both TPC and their consumers that such variation is passed through early. 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 TPC 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 its Tariff Order, the Commission directs that the total FAC to be charged to the consumers 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 TPC will carry forward the variation in costs and recover it through FAC charge in the future period.

Sd/-	Sd/-
(A. Velayutham)	(Dr. Pramod Deo)
Member	Chairman

(A.M. Khan),
Secretary, MERC.