

Supreme Court sets at rest the controversies impacting captive generating plants and investments therein

On October 9, 2023 the Supreme Court of India has rendered its final judgment in *M/s. Dakshin Gujarat Vij Company Limited v. M/s. Gayatri Shakti Paper and Board Limited And Anr.* and Batch matters settling the law on issues debated for past 15 (fifteen) years related to captive generation and use of electricity as also exemption of surcharges. The Supreme Court was called upon to settle the interpretation of Rule 3 of the Electricity Rules 2005 (“**Electricity Rules**”) given the conflicting interpretations rendered by the Appellate Tribunal for Electricity (“**APTEL**”) in the case of *Kadodara Power Pvt. Ltd. & Ors. v. Gujarat Electricity Regulatory Commission & Anr.*¹ (decided on September 22, 2009) (“**Kadodara Power**”) and *Tamil Nadu Power Producers Association v. Tamil Nadu Electricity Regulatory Commission*² (decided on June 6, 2021) (“**TNPPA**”) ³.

Findings of the Supreme Court

Supreme Court’s findings on the 3 (three) issues framed⁴ are summarized below:

1. Electricity Act and Electricity Rules recognizes 2 (two) types of captive users – single captive user and group captive user. Within the group captive users, there are only 2 (two) categories of captive users i.e., co-operative societies and association of persons.⁵
2. In a captive generating plant (“**CGP**”) there is no implied prohibition on transfer of ownership once the CGP has been set up.⁶
3. Construction, maintenance or operation of a CGP can be done by 1 (one) person or different persons.⁷
4. A CGP does not lose its captive status due to transfer of its ownership or any part of its ownership, so long as the transferee, (i.e., a new captive user) complies with the eligibility criteria specified under Rule 3, i.e., captive user/s must together hold 26% of ownership (equity share capital with voting rights) of the CGP (“**Ownership Requirement**”) and consume 51% of the aggregate electricity generated by CGP (“**Consumption Requirement**”).⁸

¹ 2009 SCC OnLine APTEL 119

² 2021 SCC OnLine APTEL 19

³ APTEL’s Judgment in TNPPA was subsequently followed in in *Sai Wardha Power Generation Limited & Ors. v. Maharashtra Electricity Regulatory Commission* 2021 SCC OnLine APTEL 78

⁴ Para 21

⁵ Para 58

⁶ Para 32

⁷ Para 32

⁸ Para 36

5. CGP can operate in 2 (two) scenarios, viz.:-
 - a) A person who constructs, maintains or operates a CGP for their own use may supply electricity to self through dedicated transmission lines.
 - b) A person who constructs, maintains or operates a CGP may supply electricity by exercising their right to open access to the grid for the purpose of carrying electricity from the CGP to the destination of use by such person.
In both scenarios cross-subsidy surcharge and additional surcharge are not payable. Wheeling charges are payable for use of the distribution system.⁹
6. Electricity generated from the CGP supplied through the grid for use of a licensee or consumer (third party), is subject to levy of such charges.
7. Consumption by a subsidiary, or holding company, when one of them is a captive user, is admissible as captive consumption by the captive user.¹⁰
8. Members of a co-operative society when they collectively satisfy the Consumption Requirement will not be liable to pay cross-subsidy surcharge or additional surcharge, irrespective of whether they use dedicated transmission lines or open access. The co-operative society may supply 49% or less of the aggregate electricity generated to third parties for which such charges will be leviable on non-captive users/ consumers.¹¹
9. The minimum Ownership Requirement must be met and satisfied throughout the year and not at the end of financial year.¹²
10. Companies or body corporates may come together and set up another company as a Special Purpose Vehicle, with a common purpose to achieve the common benefit of becoming captive user(s) and enjoy the advantages provided to captive users under the Electricity Act. Hence, special purpose vehicles are an “association of persons” in terms of the 2nd Proviso to Rule 3(1)(a). Accordingly, companies, body corporates and other persons, who are shareholders and captive users of a CGP set up by a special purpose vehicle, are, in addition to meeting the Ownership Test and Consumption Test, also required to consume electricity in proportion to their shareholding in the CGP in terms of 2nd Proviso to Rule 3(1)(a) (“**Proportionality Test**”).¹³
11. For satisfying the Proportionality Test in a group CGP, the owner of every 1% shareholding in the CGP should have minimum consumption of 1.96% of the electricity generated by the CGP, within a variation of 10%. Therefore, the unitary qualifying ratio has to be within a range of 1.764% to 2.156%. 100% of the electricity generated does not have to be taken into consideration. This ensures that there is no gaming by owners.¹⁴
12. In case of change of ownership, shareholding, or consumption, the principle of weighted average should be applied to ensure compliance with Proportionality Test. If a captive user exits or drops out in the middle of the year, transferring its shareholding to another or new captive user, the captive user who has become a shareholder in the middle of the year, is required to consume proportionately to the electricity generated. Existing captive users may enhance their consumption to take advantage of the variation. Weighted average methodology helps in calculating the relevant average shareholding of the captive user in the year and the proportionate electricity required to be consumed by him.¹⁵

⁹ Para 12 – 16

¹⁰ Para 27

¹¹ Para 28

¹² Para 39

¹³ Para 56 and 66

¹⁴ Para 43 and 45

¹⁵ Para 47

Conclusion

1. The Supreme Court has upheld the principles laid down by APTEL in Kadodara Power regarding the applicability and computation of Proportionality Test. This balanced judgement of the Supreme Court has settled a lot of issues relating to captive generation, which was meant to be promoted:
 - a) The group captive users have been recognized by the Supreme Court.
 - b) The contention of distribution licensee's that only the person who has actually constructed the power plant can be a captive user has been rejected. This should enable more consumers to take advantage of the group captive model.
 - c) Cross subsidy surcharge and additional surcharge is not leviable on captive users even if open access is utilized.
 - d) With the approval of the weighted average formula and the unitary qualifying ratio, Supreme Court has protected the interest of distribution licensees by preventing gaming and ensuring that only genuine players become part of CGPs. This will hopefully bring to an end various litigations pending on this issue. State Commission's across India will now have to follow the same methodology for checking whether Proportionality Test is satisfied. This should allay investor concerns about the State Commission's following different methodologies.
2. By holding that the captive users of a special purpose vehicle have to meet the Proportionality Test, the Supreme Court has settled the divergent views taken by APTEL on the issue, thereby creating regulatory certainty for the stakeholders.

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