

Summary of Order dated October 09, 2023  
in Civil Appeal Nos. 8527-8529 of 2009 and batch matters

### ORDER SUMMARY

Case No. Civil Appeal Nos. 8527-8529 of 2009-Dakshin Gujarat Vij Company Limited versus Gayatri Shakti Paper and Board Limited and Anr. and batch matters  
Court Name Hon'ble Supreme Court of India  
Order dated October 9, 2023  
Brief Interpretation of Rule 3 of Electricity Rules, 2005 applicable to group captive arrangement pursuant to challenge by Maharashtra Discoms and others against Orders of Ld. APTEL for various financial years  
Conspectus

#### Definitions:

1. **APTEL:** Appellate Tribunal for Electricity
2. **CGP:** Captive Generating Plant
3. **Chhattisgarh Order:** Chhattisgarh State Power Distribution Company Limited v. Chhattisgarh State Electricity Regulatory Commission and Anr. (2022) SCC Online SC 604
4. **DISCOMS:** Distribution Licensees
5. **EA, 2003:** Electricity Act, 2003
6. **FY:** Financial Year
7. **JSW Order:** Order dated Appeal No. 311 of 2018 and Appeal No. 315 of 2018 in Order in Maharashtra State Electricity Distribution Company Limited v. JSW Steel Limited and Ors.
8. **Judgement/Order:** Order dated October 09, 2023 passed in Civil Appeal Nos. 8527-8529 of 2009-Dakshin Gujarat Vij Company Limited versus Gayatri Shakti Paper and Board Limited and Anr. and batch matters
9. **Kadodara Order:** Order dated September 22, 2009 of Ld. APTEL in Kadodara Power Pvt. Ltd. and Others v. Gujarat Electricity Regulatory Commission and Anr.
10. **Rules, 2005:** Electricity Rules, 2005
11. **SPV:** Special Purpose Vehicle
12. **TNPPA Order:** APTEL judgment dated June 07, 2021 in Appeal No. 131 of 2020 – Tamil Nadu Power Producers Association (TNPPA) Vs. Tamil Nadu Electricity Commission (TNERC) and Ors.

#### Brief background:

1. There were multiple appeals before Hon'ble Supreme Court of India on issues of interpretation of Rule 3 of the Rules, 2005 which deals with captive generation.
2. Pursuant to provisions of Sections 2(47), 38(2)(d), 39(2)(d) and 42(2) of the EA, 2003, a consumer has been given the right to avail power from a source other than the area distribution licensee subject to payment of transmission and wheeling charges. Further, in addition to the aforesaid transmission/ wheeling charges, the consumer availing open access is also levied cross subsidy surcharge (**CSS**) and additional surcharge (**ASC**) by the transmission/ distribution licensees.

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- However, in order to promote captive consumption of power the consumers availing open access for sourcing power from captive generating plants are exempted from the payment of CSS and ASC [under 4th provisos of Sections 38(2)(d)(ii), 39(2)(d)(ii) and 42(2) of the EA 2003].
3. In view of the provisions of EA, 2003, read with Rule 3 of Rules, 2005 for a power plant to qualify as captive, the power plant has to have minimum 26% of equity ownership by the captive user(s)/ consumer(s), and it should consume minimum 51% of the aggregate electricity generated in such plant, on an annual basis, for captive purpose. Further in the absence of such compliance CSS and ASC is payable by the consumers availing open access.
  4. The Judgement deals with legal position in respect of interpretation of Rule 3 and methodology to calculate the 26% shareholding and 51% consumption required mandated under law.
  5. Eternity Legal represented a number of captive consumers who were respondents in batch matters viz.:  
**Civil Appeal Nos. 4611-4624/2022-**  
Tata Power Company Limited - Distribution ...Appellant  
Versus  
Sai Wardha Power Generation Limited & Ors. ...Respondents  
**Civil Appeal Nos.4532-4566/2022:**  
Tata Power Company Limited - Distribution ...Appellant  
Versus  
Sai Wardha Power Generation Limited & Ors. ...Respondents  
**and**  
**Civil Appeal No. 10378/2022**  
Maharashtra State Electricity Distribution  
Company Limited ...Appellant  
Versus  
Sai Wardha Power Generation Limited & Ors. ...Respondents

**INTERPRETATION OF PROVISIONS OF LAW:**

6. Section 9 of EA, 2003 (para 13):

The Hon'ble Court has held that under Section 9 of the EA, 2003 there can be three situations of supply of captive power:

- a. When a CGP is used to supply electricity for self-consumption through dedicated lines.
- b. When a CGP is used to supply electricity to others by exercising open access rights.

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- c. When electricity from a CGP is supplied to licensees or consumers through the grid. No separate license is required for this supply, but it must comply with regulations under Section 42(2) of the EA, 2003.
7. Section 42 of EA, 2003 (para 14):
- Proviso 4 of Section 42 of EA, 2003 provides where an individual with a CGP exercises their right to open access according to Section 9(2) of the EA, 2003. In such cases, no surcharge is applicable when invoking this right. However, the individual must pay wheeling charges to the distribution licensee for using their distribution system to transport electricity to the intended destination.
8. The Hon'ble Court has framed three issues and given its finding on the same. This summary discusses these three issues and our analysis of the same.

#### ISSUES BEFORE SUPREME COURT OF INDIA AND ITS ANALYSIS

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Issue I	Eligibility Criteria for a CGP / Captive user specified under Rule 3(1)(a) of the Rules, 2005
Findings	<p>Paragraphs 22 to 40 discusses Issue I and gives findings. The relevant portion is reproduced below:</p> <p><i>“25. To qualify as a CGP under Section 9, read with Section 2(8) of the Act, the requirements of paragraphs (i) and (ii) to Rule 3(1)(a) of the Rules have to be satisfied. We have already referred to the definition of a CGP under Section 2(8) of the Act which uses the words, “primarily for his own use”. This expression has been given statutory grain vide Rule 3 of the Rules. Rule 3 as repeatedly noticed incorporates two separate requirements. The first requirement is that the captive user(s) should have not less than 26% of the ownership in the CGP. Lower limit or minimum of 26% ownership is prescribed. Upper limit of ownership is not prescribed. The second requirement relates to the minimum electricity consumption. 51% of aggregated or more of the generated electricity should be consumed by the user(s) who meets the ownership requirement.”</i></p> <p><i>“26. The presence of the words, “not less than”, in paragraphs (i) and (ii) to Rule 3(1)(a) of the Rules reflects and shows that the stipulations with regard to 26% ownership and 51% consumption is the minimal or lowest threshold. Maximum is not prescribed. A captive user</i></p>

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	<p> <i>who owns 100% of the CGP and consumes 51% or more electricity generated from such plant would satisfy the parameters prescribed. Equally, a captive user who owns 26% of the CGP and consumes 51% or more of the electricity generated would qualify as a captive user. However, this can result in abuse or gaming where there are multiple owners with different shareholdings. In case of an association of persons, a situation which is covered by the first explanation. This aspect, when there are multiple owners, in a case of association of persons, is examined under <b>Issue II</b>"</i> </p> <p> <i>"32. We should not accept this plea for several reasons. The expression, "set up" used in clause Section 2(8) of the Act should not to be read in a pedantic manner as referring to initial set up. We should recognise the practical reality and not ignore the impractical asinine consequences of this interpretation. Section 2(8) of the Act should not be read as impliedly incorporating a prohibition to transfer of ownership once the CGP has been set up. This bar is not specifically stated and mentioned, though the legislature could have stated this in simple words. Rather, in Section 9(1) the words used are, "construct, maintain or operate a captive generating plant."</i> </p> <p> <i>"36... We agree with the said interpretation and logic. A CGP does not lose its captive status due to transfer of its ownership or any part of its ownership, provided that the transferee, that is, a new captive user, complies with eligibility criteria specified under Rule 3 of the Rules."</i> </p> <p> <i>"37... Dealing with the generation of electricity being vital for the economy of the country, a narrow interpretation will ignore realities, leading to irrational results. Section 2(8) and Section 9(2) are required to be read harmoniously with Section 9(1) of the Act. A purposive interpretation would include a subsequent owner of the CGP, who is an owner as per clause (c) to Explanation 1 to Rule 3 of the Rules."</i> </p>

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	<p><i>“39. We do not agree. The minimum threshold of ownership, which is 26%, is to be met and satisfied throughout the year and not at the end of the financial year alone...”</i></p>
<p><b>Analysis of ruling</b></p>	<p>a. To qualify as a CGP under Section 9, read with Section 2(8) of the EA, 2003, the requirements of paragraphs (i) and (ii) to Rule 3(1)(a) of the Rules, 2005 have to be satisfied. Rule 3(1)(a) of Rules, 2005 is reproduced below for ready reference:</p> <p>“ 3(1)...</p> <p><b>(a) in case of a power plant -</b></p> <p><b>(i) not less than twenty six percent of the ownership is held by the captive user(s), and</b></p> <p><b>(ii) not less than fifty one percent of the aggregate electricity generated in such plant, determined on an annual basis, is consumed for the captive use:</b></p> <p><b><i>Provided that in case of power plant set up by registered cooperative society, the conditions mentioned under paragraphs at (i) and (ii) above shall be satisfied collectively by the members of the cooperative society:</i></b></p> <p><b><i>Provided further that in case of association of persons, the captive user(s) shall hold not less than twenty six percent of the ownership of the plant in aggregate and such captive user(s) shall consume not less than fifty one percent of the electricity generated, determined on an annual basis, in proportion to their shares in ownership of the power plant within a variation not exceeding ten percent;</i></b></p> <p>...”</p> <p>b. The Hon’ble Court has held that minimal threshold of 26% shareholding and 51% consumption for captive users should be maintained throughout the year. Setting aside TNPPA Order, it was held that such threshold should be met at all times and not calculated as on end of financial year.</p> <p>c. The Hon’ble Court held that transfer of ownership is permissible and the same cannot be barred or not considered for purpose of captive determination.</p>
<p><b>Issue II</b></p>	<p><b>Application for the second proviso to Rule 3 (1) (a) of the Rules, 2005</b></p>

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<p><b>Findings</b></p>	<p>Paragraphs 41 to 48 discusses Issue II and gives findings. The relevant portion is reproduced below:</p> <p><i>“42. In <b>Kadodara Power</b>, referring to proportionality requirement, it is held: “How proportionality of consumption has to be assessed: <b>17.</b> The Electricity Rules 2005 have set down that not less than 51% of the aggregate electricity generated by a CGP, determined on an annual basis is consumed for captive use. However, in case there are more than one owner then there is a further rule of proportionality in consumption. In case the power plant is set up by a cooperative society the condition of use of 51% can be satisfied collectively by the members of the cooperative society. However, if it is an 'association of persons' then the captive users are required to hold not less than 26% of the ownership of the plant and such captive users are required to consume not less than 51% of electricity generated determined on an annual basis in proportion to the share of the ownership of the power plant within a variation not exceeding +/- 10%. For example, if a CGP produces 10,000 kWh of electricity, 5100 kWh need to be consumed by the owners of CGP. In case there are three owners holding equal share, each one must consume 1/3rd of the 5100 kWh within a variation of +/-10% i.e. between 1530 kWh to 1870 kWh. It will not be proper to assess the proportionality of the consumption on 100% of the generation. The Commission, however, appears to have calculated the proportion of use to 100% of the total consumption which may be more than 51% of generation....”</i></p> <p><i>We agree with the said reasoning in <b>Kadodara Power</b>...”</i></p> <p><i>“43. The last portion of the second proviso to Rule 3(1)(a) of the Rules, that is, the proportionality principle, specifies an unitary qualifying ratio. The unitary qualifying ratio is the consumption requirement divided by the shareholding requirement, that is, 51% divided by 26%. This means that the owner of every 1% shareholding of the CGP should have minimum consumption of 1.96% of the electricity generated by the CGP, with a variation of +/-10% being permissible. Therefore, the unitary qualifying ratio has to be within a range of 1.764% to 2.156%. In other words, we do not take into consideration 100% of the electricity generated. Instead, we apply the shareholding requirement, which should not be less than 26% in aggregate, to the electricity consumed, which should not be less than 51%, and thereby compute whether the ownership criteria and the proportionate consumption criteria is satisfied. Benefit of variation by 10% either way is to be a given”</i></p>

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	<p> <i>“46. This brings us to the question of applicability of the second proviso of Rule 3(1)(a) in cases where there is a change in ownership or shareholding of the CGP. An issue arises with respect to calculation of proportional consumption of electricity under the second proviso to Rule 3(1)(a) of the Rules when an existing captive user exits/transfers their shareholding/ownership to a new captive user. It may happen in multiple situations. The APTEL in <b>Tamil Nadu Power</b> had postulated that such issue would be resolved if the minimum consumption and shareholding requirements are verified only at the end of the financial year. However, we have held that the minimum consumption and shareholding requirement are required to be maintained continuously and not just at the end of the year. It is only with respect to determining the ownership proportionate to consumption of electricity that requires our attention, with respect to the second proviso to Rule 3(1)(a) of the Rules”</i> </p> <p> <i>“47. In case of change of ownership, shareholding, or consumption, the principle of weighted average should be applied to ensure compliance of the proportional electricity consumption requirement stipulated under the second proviso to Rule 3(1)(a). For instance, if a captive consumer exits or drops out in the middle of the year, transferring its shareholding to another or new captive user, it would be fair to hold that the captive user who has become a shareholder in the middle of the year, is required to consume proportionately to the electricity generated. In a given case, existing captive users taking advantage of the variation, may enhance their consumption. The concept of weighted average shareholding comes in aid to calculate the relevant average shareholding of the captive user in the year and the proportionate electricity required to be consumed by him. To borrow from the illustrations provided by learned Senior Advocate Mr. Basava Prabhu Patil, appearing on behalf of Tata Power Company Limited, this comes in aid in instances where the shareholding of a captive user in a CGP fluctuates, provided that the minimum ownership requirement of 26% in aggregate is not being breached. Further, a shareholder may hold 30% of shares of the CGP for 3 months, 40% of shares for 4 months, and 50% of the shares for the balance 12 months. The weighted average shareholding method is applied by taking average shareholding held by particular shareholder for the year for the purpose of calculating proportionate electricity required to be consumed by it in terms of the second proviso of Rule 3(1)(a)”</i> </p> <p> <i>“48. We agree with the reasoning and logic, that weighted shareholding and proportionate consumption of electricity is the fair, equitable</i> </p>

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	<p><i>and the correct method to determine whether the essential requirements of the second proviso to Rule 3(1)(a) are satisfied”</i></p>
<p><b>Analysis of ruling</b></p>	<p>a. The provision of test of proportionality in Kadodara Order was upheld. The Hon’ble Court observed that owner of every 1% shareholding of the CGP should have minimum consumption of 1.96% of the electricity generated by the CGP, with a variation of +/-10% being permissible. Thus, the unitary qualifying ratio has to be within a range of 1.764% to 2.156%</p> <p>b. The Hon’ble Court referred to certain illustrations in paragraph No. 44 of the Order for clarification of methodology for calculation of proportionality in different circumstances.</p> <p>c. Hon’ble Court further held that situations of ownership or shareholding changes, a weighted average principle should be applied to ensure compliance with the proportional electricity consumption requirement specified in the second proviso to Rule 3(1)(a). The Hon’ble Court gave the following example where a captive user exits or transfers shareholding to a new captive user during the year, and the new user is expected to consume electricity proportionate to the shareholding. The concept of weighted average shareholding is applied, considering the average shareholding held by a shareholder throughout the year to calculate the proportionate electricity consumption.</p> <div data-bbox="386 1241 1432 1707" style="border: 1px solid black; padding: 5px;"> <p>Example and its explanation:</p> <p>There is a specific shareholder who initially holds 30% of the shares of the CGP for 3 months, then increases their shareholding to 40% for the next 4 months, and finally ends the year with a 50% shareholding for the remaining 12 months.</p> <p>Now, to determine how much electricity this shareholder is required to consumed in compliance with the Rules, 2005 the concept of a weighted average shareholding is employed. This means that instead of simply calculating an average shareholding percentage across the entire year (which would be 40% in this case), the calculation takes into account the changing shareholding proportions during different periods of the year. This weighted average shareholding is then used to determine the proportionate amount of electricity they are required to consume according to the second proviso of Rule 3(1)(a).</p> </div> <p>It is imperative to note that if weighted average is applied then whether any CGP can commence operation anytime during the year or has to commence operation only on April 1 is unclear, as in case the weighted average is applied, then even if 26% is held at the time</p>



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	<p>of such commencement in middle of year, the CGP will fail to fulfil minimum shareholding criteria.</p>
<p><b>Issue III</b></p>	<p><b>Whether a company set up as SPV for generating electricity is an “association of persons” which must meet the proportionality requirement specified in the second proviso to Rule 3 (1) (a) of the Rules.</b></p>
<p><b>Findings</b></p>	<p>Paragraphs 49 to 66 discusses Issue III and gives findings. The relevant portion is reproduced below:</p> <p><i>“49. This brings us to the last issue and question – whether a company set up as a SPV, in view of clause Rule 3(1)(b) of the Rules, is absolved from meeting the eligibility criteria specified in paragraphs (i) and (ii) of Rule 3(1)(a) of the Rules read with second proviso to Rule 3(1)(a) of the Rules. This argument was raised and accepted in <b>Tamil Nadu Power</b> on the following grounds:...”</i></p> <p><i>“51. We agree with the reasoning giving in <b>Kadodara Power</b> Rule 3(1)(b) of the Rules does not negate or undo the eligibility requirements specified in paragraphs (i) and (ii) to Rule 3(1)(a) of the Rules, which in case of an association of persons mandates the satisfaction of the proportionality requirement under the second proviso to Rules 3(1)(a). Rule 3(1)(b) refers to a situation where a company set up as a SPV has multiple units generating electricity. It stipulates that the company formed as a SPV can identify one or more of such generating units for its captive use. All the generating units need not be identified for captive use. The units which are not identified for captive use need not satisfy the conditions mentioned in paragraphs (i) and (ii) of Rule 3(1)(a) of the Rules. Electricity generated by these unidentified units need not be accounted and considered. The explanation clarifies the situation as it states that the requirement of consumption of electricity by captive users shall be determined with reference to the generating unit or units identified for captive use. The unit or units identified for captive use, in other words, must satisfy the requirements of paragraphs (i) and (ii) of Rule 3(1)(a) of the Rules read with the second proviso. This is also clear from Rule 3(2), which states that the equity shares held by the captive user in the generating station, which is identified for captive use, should not be less than 26% of the proportionate equity of the company relating to the generating unit or units identified as a CGP</i></p> <p>...</p> <p><i>Thus, Rule 3(1)(b) of the Rules liberalises, gives flexibility and an option when a generating station owned by company, incorporated as a SPV, has multiple</i></p>

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	<p><i>generating units. Rule 3(1)(b) does not undo or override the eligibility criteria specified under Rule 3(1)(a) read with second proviso.”</i></p> <p><i>“58. Our reasoning is in consonance with section 2(8) of the Act, which defines a CGP, and as noticed above categorises CGPs into two categories: i) Single User CGP – the first part of Section 2(8) refers to a power plant set up by any person to generate electricity primarily for his own use; and ii) Group User CGP – the second part of Section 2(8) states that the power plant set up by any person to generate electricity primarily for their own use includes a power plant set up by any cooperative society or association of persons for generating electricity primarily for the use of members of such cooperative society or association. No other category of CGP is recognised under Section 2(8) of the Act.”</i></p> <p><i>“64. An association of companies or body corporates thus are required to comply with Rule 3(1)(a) read with the second proviso to Rule 3(1)(a). Equally, an association of companies, body corporates, or other persons that set up a SPV which owns, maintains, and operates a CGP is required to comply with Rule 3(1)(a) read with the second proviso to Rule 3(1)(a). A SPV in this regard may be company, but it also is also an association of persons in terms of the second proviso to Rule 3(1)(a).”</i></p> <p><i>“66. In view of the aforesaid reasoning, we hold that SPVs which own, operate and maintain CGPs are an “association of persons” in terms of the second proviso to Rule 3(1)(a) of the Rules. Companies, body corporates and other persons, who are shareholders and captive users of a CGP set up by a SPV, are required to comply with Rule 3(1)(a) of the Rules read with the second proviso of the Rules.”</i></p>
<p><b>Analysis of Ruling</b></p>	<p>a. It was held that a SPV is an AOP for purpose in terms of Rules, 2005.</p> <p>b. The Hon’ble Court held that Special Purpose Vehicles (SPVs), as defined by the Rules, 2005 are entities with a specific purpose: to own, operate, and maintain a generating station. These SPVs are not allowed to consume the electricity generated by the CGP themselves because their sole function is to manage the generating station. Consequently, they cannot be considered as captive users since their exclusive role is the ownership and operation of the CGP.</p> <p>c. The primary reason for companies or other legal entities to establish SPVs, even though the SPV itself cannot benefit from the privileges provided to captive users, is to enable the individual entities involved to collectively enjoy the advantages of being classified as captive users. In essence, the creation of SPVs facilitates these</p>

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	<p>entities in collectively reaping the benefits of captive user status even though the SPV, as an entity, cannot directly avail these benefits.</p> <p>d. The Hon'ble Court recognised single user captive plant and group captive plant/CGP. It was held that group captive users are not registered cooperative societies, the rule of proportionality under the second proviso to Rule 3(1)(a) of the Rules, 2005 should be read as a mandatory condition.</p> <p>e. It was held that second proviso to Rule 3(1)(a) is not specific to particular cases and should be treated as a general rule. Proviso to Rule 3(1)(a) should be seen as integral to Section 2(8) of the EA, 2003, particularly its "primarily for its own use" interpretation. This proviso ensures that in cases where group captive users are not registered cooperative societies, the principle of proportionality specified in the second proviso must be considered mandatory. It was held that Rule 3(1)(b) should not be interpreted to override or prevail over Rule 3(1)(a), as it could lead to potential misuse or abuse of the provisions. It underscores the importance of interpreting provisions in a way that aligns with the legislative intent and the object and purpose of the Rules, 2005.</p> <p>f. Therefore, the proportionality criteria with variation of 10% applies even in case of SPV.</p>

**Eternity Legal**

**Date: October 11, 2023**

**Place: Mumbai**

*Note: This summary is prepared only for private circulation and intended addressees only. In any event, no person shall be entitled to rely upon the views expressed herein without our prior written consent, and any reliance upon the same shall be restricted to the situation specifically referred to above.*