OIL AND GAS REGULATORY AUTHORITY

August 6, 2002

Case No. OGRA-6(2)-2/2002-I

REVENUE REQUIREMENT DETERMINATION
IN CASE NO. OGRA/______________

Petitioner

Sui Southern Gas Company Limited (Petitioner)

Interveners

[Consumer Rights Commission of Pakistan (CRCP)]

[All Pakistan Textiles Mills Association (APTMA)]

OIL AND GAS REGULATORY AUTHORITY

Chairman	Mr. Munir Ahmad
Vice Chairman and Member (Gas)	Mr. Jawaid Inam
Member (Oil)	Vacant
Member (Finance)	Vacant

BACKGROUND

1. Sui Southern Gas Company Limited, (Petitioner) is a public limited company incorporated in Pakistan and is listed on the Karachi, Lahore and Islamabad Stock Exchanges. The Petitioner is engaged in the business of construction and operation of transmission and distribution pipelines, sale of natural gas, manufacturing and sale of gas meters and sale of gas condensate as a by-product. The Petitioner was also previously engaged in the trading of Liquefied Petroleum Gas (LPG). However, the LPG operations were discontinued last year as a consequence of the sale of the business to Caltex Oil Pakistan Limited.

2. The Petitioner under section 8 of the Oil and Gas Regulatory Authority Ordinance, 2002 filed a petition (the Petition) before the Authority on April 26, 2002 seeking, inter alia, increase in prescribed prices of the Petitioner by Rs. 5.11 per MCF in each category of consumers, to meet a net shortfall of Rs. 1,178 Million in its revenue requirement for financial year 2001-02, due to the following factors:

   a. Increase in net asset base resulting in increased revenue requirement in order to maintain 17% return on Petitioner's average net assets as required under the ADB loan covenants.

   b. Increase in the well head prices of gas producers.

   c. Increase in Transmission & Distribution costs.

3. In addition, the Petitioner has requested an upward adjustment of

Rs. 2.24 per MCF in prescribed prices on account of gain on sale of LPG business. This brings the total tariff increase requirement to Rs. 7.35 per MCF w.e.f. July 01, 2001.

4. While submitting further information, the Petitioner indicated that there had been changes since the filing of the Petition based on nine months actual results.

5. On the basis of revised information submitted by the Petitioner, the Authority decided that a prima facie case for evaluation exists, hence, admitted the application for consideration on 13th May, 2002.

6. Notice inviting comments from all the consumers, general public, interested or affected persons and parties on the Petition was published on 21st June, 2002 in three English and one Urdu national dailies. The Authority received five communications relating to the Petition, which were relevant to the subject matter. Two of these communicators applied to intervene in the proceedings as parties, namely:

   (i) Consumer Rights Commission of Pakistan (CRCP)

   (ii) All Pakistan Textiles Mills Association (APTMA)

   Their intervention applications were accepted. Having examined the Petition and the above said communications, the Authority decided to hold a public hearing in the proceedings. Notice intimating the time and place of the public hearing and extension of date for filing comments / objections / intervention was published in the newspapers on July 11, 2002. The public hearing commenced on 26th July, 2002 and ended on the same day.

7. SALIENT FEATURES OF THE PETITION

The Petitioner submits that:

7.1. Under the provisions of Asian Development Bank Agreement the Petitioner is eligible to an annual return of not less than 17% on the value of its average net operating fixed assets (net of deferred credit), before corporate income taxes, interest and other charges on debt. Accordingly, the revenue determination of the Petitioner shall also cater for the cost of gas at wellhead and T&D cost which is notified as the prescribed price for the Petitioner.

7.2. The net operating assets are projected to increase from Rs. 16,786 Million to Rs. 17,621 Million during the financial year 2001-02.

7.3. Based on the average net operating assets, the required return at 17% is computed at Rs. 2,682 Million.

7.4. **Net operating revenues** are projected at Rs. 28,823 Million, break up of which is as follows:

Particulars	***Amount Rs. in Millions***
Net Sales at current tariff	27,976
Meter Rentals	413
Amortization of deferred credit	119
Sale of Gas Condensate	154

Gas transportation charges	52
Other income	109
Net operating revenues	**28,823**

7.4.1. Late payment surcharge is projected at Rs. 201 Million but has been excluded from the calculations of revenue requirement and treated as non-operating income.

7.4.2. Meter manufacturing business profits are projected at Rs. 29.834 million but have been excluded from the calculations of revenue requirement, on the basis that it is not a regulated activity.

7.5. **Net operating expenses** are projected at Rs. 27,259 Million, detailed break up of which is as follows:

Particulars	***Amount Rs. in Millions***
Cost of Gas	22,138
Transmission and Distribution cost	2,894
Depreciation	2,159
Other charges	68
Net operating expenses	**27,259**

7.5.1. Unaccounted for Gas (UFG) is projected at 7.75 % (19,363 MMSCF).

The shortfall in the revenue requirement has been calculated at Rs. 1,178 Million, which stipulates an increase of Rs. 5.11 per MCF in the prescribed prices as detailed.

Particulars	***Amount Rs. in Millions***
Net operating revenues	28,823
Net operating expenses	27,259
Return obtainable	1,564
Return required	2,682
Shortfall in the revenue requirement	1,118
Revenue shortfall after grossing up	1,178
Increase requested in prescribed prices (Rs/MCF)	Rs. **5.11** per MCF
Upward adjustment on account of gain on sale of LPG business (Rs/MCF)	Rs. 2.24 per MCF
Total Increase requested (Rs/MCF)	Rs. **7.35** per MCF

7.6. Based on the aforesaid submissions, an increase of Rs. 7.35 per MCF is required in the prescribed price.

8. <u>WRITTEN SUBMISSIONS OF INTERVENERS AND RESPONSES THERETO</u>

8.1. <u>CONSUMER RIGHTS COMMISSION OF PAKISTAN</u>

Consumer Rights Commission of Pakistan finds no reason to allow the Petitioner to meet its revenue shortfall from Gas Development Surcharge (GDS) as the fixed amount of return allowed to the company dispelled all incentives to improve its performance. OGRA should prevent the Petitioner from becoming further inefficient by directing it to reduce its expenditure to minimum possible.

8.1.1. The entitlement of 17% fixed return on average net fixed assets should not be the sole criterion to meet the revenue shortfall. The Petitioner, therefore, does not put a check on its increasing cost of service, which has increased due to inefficiency, mismanagement and insensitivity to consumer stakes.

8.1.2. An increase in transmission and distribution cost by Rs. 0.22 per MCF would amount to paying the company for its inefficiency through the tariff increase.

8.1.3. Although percentage-wise UFG has decreased, but still it is on the high side, which is accounted for in the tariff calculation.

8.1.4. An increase in of 18 % in salaries, wages and benefits, which is a part of T&D cost, is very high as against the prevailing domestic inflation rate of 4%. Any salary increase should be directly related to increased productivity both in case of executives and unionized staff.

8.1.5. The increase in the current year prescribed price, adjusted through Gas Development Surcharge, would definitely affect the consumer gas price for the next year.

8.1.6. As the Petitioner charges meter rent from domestic and commercial consumers, the transmission losses occurring due to meter errors should not be passed on to the consumers.

8.1.7. Late payment surcharge should be treated as operating profit because it relates to the gas sales, which is a regulated activity.

8.1.8. The Authority should ensure the accuracy and reliability of the data provided in the Petition.

8.1.9. The intervener also inquires about the figures on receivables which in his view were missing and vague.

8.1.10. CRCP emphasizes that the Petitioner be directed to control its revenue expenditures and its Petition for tariff raise be dismissed.

8.2. ***<u>RESPONSE OF THE PETITIONER</u>***

Para wise response of the Petitioner is summarized below:

8.2.1. This is a general statement.

8.2.2. This is a general statement.

8.2.3. Increase in T&D cost is attributable to extra cost of maintenance incurred on old pipelines and increase in transmission and distribution network.

8.2.4. Efforts are being made to further reduce the UFG.

8.2.5. Wages of subordinate staff are revised every 2 years through Settlement (Under Industrial Relations Ordinance) between the CBA and the management. Salaries of executives have been revised under the Compensation Package, based on market survey as their salaries were substantially lower as compared to similar industry. It is difficult for the Petitioner to hire/retain quality people, a necessity to be able to provide quality service.

8.2.6. No comments

8.2.7. The transmission gas losses are attributable to measurement errors, which are acceptable upto 2%. The actual transmission loss for the year is 0.65%. These losses were not due to recordings by domestic meters installed in the distribution system.

8.2.8. Late payment surcharge is treated as a non operating item while computing tariff requirement as delayed payment directly affects cash flow of the Petitioner, which resultantly increases financial charges. Following the principle of consistency, financial charges are excluded from total operating expenses.

8.2.9. The reliability of the Petitioner's financial data has never been questioned as the accounts are audited by a leading firm of Chartered Accountants and Auditor General of Pakistan.

8.2.10. Receivables include amount due from GOP under exchange risk coverage scheme amounting to Rs

1,200 Million. The break-up is as follows:

(Rs. In Million)

- Receivable from GOP 1,284
- Notes receivable-KESC 375
- Others 344

2,003

The recoverable taxation to the tune of Rs 274.973 million represents advance payment of tax adjustable against future tax liability for the financial year 2001-02.

8.3. ALL PAKISTAN TEXTILES MILLS ASSOCIATION (APTMA)

In their comments APTMA raises different points. The points raised by APTMA are summarized below:-

8.3.1. It is unjustified to consider and implement an increase in gas prices as under the Privatization Policy, the private management of these companies would be de-regulated. APTMA demands that it should be mandatory for the private management to obtain GOP approval before increasing gas tariffs.

8.3.2. The current year's increase in Prescribed Price will affect the GDS, sooner or later the GOP is likely to bring GDS to the same level, which will affect the consumer's price, therefore, APTMA opposes the increase in the revenue requirement.

8.3.3. The profit of the Petitioner is not linked with the operating performance and is allowed 17% return on its net fixed assets (as per covenants with ADB). This undue privilege of guaranteed return allowed to the Petitioner is promoting operational inefficiency, wastage and corruption. The Petitioner should be given quantitative targets for improvement of its operating performance, which shall eliminate the need for any increase in the revenue requirement.

8.3.4. The Petitioner has shown a profit before taxation of Rs. 2,400 Million amounting to 22% on net fix operating assets against the requirement of 17%. Therefore, gas rates should be reduced.

8.3.5. The Petitioner shows its transmission and distribution costs as Rs. 2,890 Million, which is very high as compare to other companies around the world.

8.3.6. The Petitioner's projected capital investment programme of Rs. 28,630 Million is heavy and unjustified keeping in view the privatization of the company.

8.3.7. Trade debts are unrecovered /uncollected by the company for over four months. By reducing it to 30 days the company will have additional cash inflow to off set any future increase in rates.

8.3.8. By reducing level of stores, spares and stock, the Petitioner shall increase cash of over Rs. 7.00 million p.a.

8.3.9. There is no justification for requesting an increase, having reserves of over Rs. 2,600 Million.

8.4. RESPONSE OF THE PETITIONER

The Petitioner's para-wise response to the points raised by APTMA is summarized below:

8.4.1. Tariff determination lies in normal course of business since the Petitioner is required to meet the revision/adjustment in well-head prices twice a year and hence it cannot be linked with the privatization. Also the tariff revision is required to meet the additional investment in the transmission and distribution system and maintenance thereof due to the ever increasing age of pipeline system. The OGRA has been constituted to regulate the utilities irrespective of it being in public or private sector.

8.4.2. Reason for revision has already been stated.

8.4.3. The Petitioner's capital expenditure is approved by its Board of Directors to meet the growing demand of new gas connections and extension of the transmission system to accept gas supplies for new gas fields. The Petitioner carefully evaluates and ensures that the requirement of fixed assets is genuine and endeavors to improve operational efficiency.

8.4.4. The stated return of 22% is based on some error in calculation by APTMA. The current position is as follow:

(Rs. In Million)

Net Average fixed assets (net of deferred credit)	15.779
Revenue requirement @ 17%	2,682
Financial Charges	(943)
Non-operating Income	662
Profit before Tax as per Profit & Loss Account	2,401

8.4.5. The Petitioner's operations are very complex, highly technical and need continuous maintenance. As regards the comparison with other companies, it is not possible because of their having different geography, climate and socio-economic environment.

8.4.6. The linkage of newly discovered gas fields to the Petitioner's transmission / distribution system is necessary for the early and efficient utilization of these gas fields. This will also add to the value of assets at the time of Privatization.

8.4.7. The amount of Rs. 7,370 Million includes sale of June billed in July and credit sale to WAPDA for last

60 days up to end of June. Out of the remaining receivables, Rs. 2,789 Million are overdue towards KESC and WAPDA and Rs. 1,345 Million are overdue from 1.6 million consumers and recovery firms have been appointed for the purpose to improve the recovery process.

8.4.8. Stock of stores and spares have to be kept to meet emergencies and day to day running of business due to operation & maintenance of Petitioner's system.

8.4.9. The reserves are already invested in company's operation and do not represent cash available, instead they are part of equity. The company has not been providing adequate return to shareholders.

9. COMMENTS

The following comments received by the Authority have also been taken into consideration. The Petitioner has also responded to the observations made on these comments, which have been taken into consideration by the Authority.

9.1. QUALITY ADVISORS (PVT.) LIMITED THROUGH DR. S.M.BHUTTA

Dr. S. M. Bhutta, appearing on behalf of Quality Advisors makes the following suggestions / observations:

9.1.1. The performance standards, based upon the international practices and ISO standards, need to be prescribed and implemented faithfully. This is required to ensure the safety, reliability and economy of the system and its equipment.

9.1.2. The procedures / standards for design, manufacturing, construction and the testing of equipment need to be prescribed by following the international standards.

9.1.3. The private sector should be encouraged to establish their testing facilities to be made available to all at a prescribed fee.

9.1.4. The certificates of these testing labs should be accredited by the international agencies and accepted by OGRA.

9.1.5. In order to minimize the pollution of the environment, the benefits announced by the International Environmental Agencies should be accounted for. Their calculation should be carried out by following the Asian Development Bank formula. This way the cash benefits should be sought by reducing atmospheric pollution through comparatively less obnoxious emissions by replacing use of high sulfur oil by gas in power generation as well as in transportation sector.

9.1.6. About 20% more efficiency of the gas turbines can be achieved by using natural gas instead of furnace oil in the power generation by gas turbine and combined cycle. This will result in foreign exchange saving of almost half a billion US dollars by using natural gas instead of imported furnace oil.

9.1.7. Gas turbine and diesel generating plants, by using natural gas, will not only save the foreign exchange but also be able to meet peaking electricity demand, reducing the loss of power transmission and maintaining voltage profile by getting them installed near to load centers.

9.1.8. Preference should be given to the locally manufactured equipment to meet the increasing demand.

9.1.9. Achievable targets should be given to reduce the losses of transmission & distribution (technical and administrative).

9.1.10. Gas development surcharge should not be applicable to the present consumers. This should be recovered from the future prospective consumers.

9.1.11. Prices of Compressed Natural Gas (CNG) for transport should not be increased to facilitate switching over vehicles from diesel & petrol to gas.

9.1.12. Prices of gas for industry should not be increased, since it will enhance cost of end products affecting exports.

9.2. <u>RESPONSE OF THE PETITIONER</u>

Para wise response of the Petitioner is summarized below:

9.2.1. Petitioner observes and implements all relevant International Standards in the performance of its transmission and distribution operations.

9.2.2. The design, engineering and construction of Petitioner's gas transmission, distribution facilities are undertaken in accordance with relevant International Standards.

9.2.3. Petitioner encourages and utilizes all the available testing facilities in Pakistan whenever required, to support Petitioner's Quality Assurance Program.

9.2.4. Petitioner endorses and supports the necessity of establishment of more testing facilities in private sector and accreditation by International Agencies e.g. ASMI, API etc and approval by OGRA.

9.2.5. Natural gas is considered to be a clean fuel and has lowest harmful emissions compared to other fossil fuels as given below:

Fuel	Sox	NOx	Co2	Particulates
Natural Gas	0	20.27	57	2
Oil	68	71	80	20.40
Coal	100	100	100	100

9.2.6. Petitioner supports the view that more combined cycle power plants based on natural gas be established for better fuel efficiency and savings in foreign exchange on input of fuel oils.

9.2.7. The technology for conversion of Diesel Power

Gen-set on natural gas is available, however, we do not know if it is being used in Pakistan.

9.2.8. Petitioner uses locally manufactured equipment such as line pipe, regulators, service valves, service tees, gas meters, scrubbers, filter elements, gaskets etc.

9.2.9. Petitioner has strict policy of reducing gas transmission and distribution losses and has achieved considerable reduction and intends to further reduce these from 8% to 6% during next 3 years.

9.2.10. No Comments

9.2.11. No Comments

9.2.12. No Comments

9.3. FEDERAL B. AREA ASSOCIATION OF TRADE AND INDUSTRY

Federal B. Area Association of Trade and Industry have made the following observations:

9.3.1. Industry cannot bear any further increase in prices of utilities as the exports shall suffer grossly due to such an increase.

9.3.2. Petitioner instead of reducing line losses and other so many expenditures has resorted to unimaginative procurement, unwarranted spending increased line losses, bungling &

extensive corruption, etc.

9.3.3. Annual Report of the Petitioner shows maladministration and unimaginative working. The Petitioner could not carryout proper planning and wasted several billion rupees to finance new projects rather it could have saved hundreds of millions by having effective control over its management and corruption. F.B Area Association supports its case by mentioning certain incidents of corruption as follows:

a. Rs. 1 Million shown spent on controlling line losses, whereas the line losses increased two folds from Rs. 1,322 Million to Rs. 2,443 Million.

b. Rs. 130 Million spent on Sui patients in eight months on hospitalization in Karachi, which has surpassed all expenditure records.

c. Rs. 20 Million spent on providing Hepatitis B vaccine to the employees and dependents. The matter is under probe.

d. Unbranded / obsolete computers purchased for Rs. 87 Million. The matter is under probe.

e. 174 management trainees reinstated by the Supreme Court are sitting idle at home and receiving salaries worth Rs. 140 Million annually. Instead of employing the trainees, management has hired 400 executives on contract costing Rs. 240 Million to the Petitioner.

f. By changing the billing system from volumetric to heating value, the Petitioner is earning extra revenue of over Rs. 1,000 Million.

9.4. RESPONSE OF THE PETITIONER

The Petitioner's reply to the observations are summarized below:

9.4.1. Issues raised are not relevant to present Petition. The number of consumers for domestic and commercial / industrial increased by 97% and 50% over the past 10 years and similarly the gas sale value has increased up to 257%, which has resulted in some increase in expenses. Necessary steps have been taken to curtail its expenses so that increase in cost of gas may not be passed on to the consumers. The Petitioner has also replied to the corruption cases mentioned by the Association as follows:

a. Rs. 140 Million have been spent on rehabilitation of old leaking lines. Necessary measures are being taken by the Petitioner to further reduce the UFG level.

b. An amount of Rs. 90 Million was incurred on Sui patients during 12 months of last financial year. The Petitioner has observed that the medical expenses are on higher side and the matter is being investigated.

c. Amount spent on providing Hepatitis B vaccine to employees was Rs. 4.00 Million. The high cost on medical treatment of employees suffering from Hepatitis B has to be borne by the Petitioner. This epidemic prompted the management to take preventive measures and immunize the staff in greater risk areas.

d. 118 P-III (being the latest) computers were procured by the Petitioner at a cost of Rs. 5.658 Million through a competitive bidding process.

e. 124 management trainees were politically inducted and have not been given postings as there were no vacancies commensurate with their skills and competence. 93 executives were hired on contract, on the basis of their skills and competence as per Petitioner's requirement.

f. The change in billing system is in line with the decision of GOP and the marginal increase in revenue becomes part of tariff adjustment calculations.

10. POINTS CONSIDERED DURING THE PROCEEDINGS

The following points were considered by the Authority during the proceedings:

a. Rate of Return
b. Operating fixed assets
c. Operating revenues
d. Late payment surcharge
e. Profit from meter manufacturing
f. Operating expenses
g. Unaccounted for gas
h. Proceeds of sale of LPG business
i. Standards for design, construction and testing
j. Gas Development Surcharge

The Authority, after taking into consideration the points raised by the interveners, the clarifications provided by the Petitioner and Authority's own scrutiny of the Petition, makes its determination as follows:

11. Rate of Return on Assets

k. The Petitioner is calculating its revenue requirement on the basis of 17% return on average net fixed operating assets in accordance with covenants agreed with the Asian Development Bank.

l. CRCP is of the view, that in presence of legal umbrella regarding 17% guaranteed return, the Petitioner does not feel it obligatory to improve its efficiency and to put a check on its increasing revenue requirement, which has increased due to its inefficiency, mismanagement and insensitivity to consumer stakes.

m. APTMA is of the view that the Petitioner is allowed 17% return on its net fixed assets (as per covenants with ADB) and the undue privilege of guaranteed return allowed to the Petitioner is promoting operational inefficiency, wastage and corruption. APTMA stresses that the Petitioner should be given quantative targets for improvement of its operating performance, which shall eliminate the need for any increase in the revenue requirement.

n. Under Section 6(2)(t) of the OGRA Ordinance, the Authority in consultation with the Federal Government and the Licensees, is required to determine a reasonable rate of return, for each Licensee, for its regulated activity, keeping in view all the circumstances.

o. This statutory duty is to be discharged by the Authority in accordance with the requirements laid down in the OGRA Ordinance, namely, the determination has to keep in view all the circumstances and the Authority must consult the Federal Government and the Licensees, prior to making such a determination.

11.1 The Authority has commenced this consultation process. As a first step, the Authority has arranged grant funds from a multilateral donor agency (Public Private Infrastructure Advisory Facility) and initiated the process of a comprehensive study on the options for the determination of a reasonable rate of return for its Licensees keeping in view the circumstances prevailing in the country. The terms of reference have already been circulated to the Federal

Government and the Licensees for their comments. The study is being executed by the World Bank, which has already advertised for expression of interest in the international and domestic print media.

11.2 After completion of the above study, the Authority shall, based on the recommendations therein, consult the Federal Government and the Licensees prior to taking any decision on the most suitable option to be adopted for the determination of a reasonable rate of return for the Petitioner.

11.3 In the meantime, the Authority has been advised by the Federal Government that the loan agreement between the Petitioner and Asian Development Bank governs the tariff policy of the Federal Government in respect of the Petitioner. This position is accepted by the Petitioner. Therefore, until the consultation process as mentioned above is completed, enabling a structured and informed decision in the matter, the Authority feels that it is appropriate to determine the revenue requirement of the Petitioner in accordance with the policy of the Federal Government.

11. Operating Fixed Assets

12.1. The Petitioner has projected the net operating assets at Rs. 17,621.228 Million in the FY 2001-02 as follows:

Amount
Rs. in Million

• Net assets at the beginning of the financial year 2001-02	16,785.918
• Net assets at the beginning of the financial year 2001-02	16,785.918
• Net assets at the close of the financial year 2001-02	17,621.228
• Net average operating assets during the financial year 2001-02	**17,203.573**
• Additions during the financial year 2001-02	
• Transmission	1,131.954
• Distribution	1,843.688
• Others	421.614
Total	**3,397.256**

12.2. APTMA and CRCP are of the view that fixed amount of return of 17% allowed on net operating fixed assets to the Petitioner is too high, and has dispelled all incentives to improve performance. Therefore, the Petitioner's management has a disincentive for improving its performance and efficiency. Besides, heavy capital expenditure on the eve of privatization is absolutely unjustified. In response to the intervener's submissions, the Petitioner has clarified that it is entitled to a minimum of 17% return on assets under an agreement with Asian Development Bank, guaranteed by the Government of Pakistan. Infrastructure Development Plans are inevitable because the newly developed gas fields have to be connected with the existing network to meet the growing demand, as the existing gas fields are depleting.

12.3. The Authority feels that only those assets which would be commissioned by 30th June, 2002, being the close of the financial year 2001-02 for which revenue requirement is being determined, shall be included in the asset base. Accordingly, the asset base has been revised thereby reducing it from Rs. 17,621.228 Million to Rs. 16,409.605 Million as follows:

Fixed Asset Additions for FY 2001-2002
Rs. In Million

	2001-2002 (Original)	2001-2002 (Revised)	Difference	*Percentage Increase / (Decrease) %*
Land	54.432	14.614	(39.818)	(73.15)
Building	89.085	14.689	(74.396)	(83.51)
Purification Plant	0	51.367	51.367	-
Transmission Line	1,131.954	319.214	(812.740)	(71.80)
Compressors	9.700	0	(9.700)	(100.00)
Plant and Mach.	104.055	23.053	(81.002)	(77.85)
Gas distribution sys.	1,843.688	1,450.933	(392.755)	(21.30)
Furniture and Fixture	40.823	32.248	(8.575)	(21.01)
Telecom. System	3.339		(3.339)	(100.00)
Tools	22.990	9.970	(13.020)	(56.63)
Vehicles	106.759	65.180	(41.579)	(38.95)
Total additions	**3,406.823**	**1,981.268**	(1,425.555)	(41.85)
Deletions	**(9.567)**	**(53.131)**	43.564	455
Net Additions in Asset Base	**3,397.256**	**1,928.137**		

	Rs. In Million
Downward Revision in Asset Base	823
Less: Charged to depreciation	(167)
	656

Fixed assets as at June 30, 2002
Rs. in Million

	2001-2001 (Original)	2001-2002 (Revised)	Difference	*Percentage %* **Increase /**

				(Decrease)
Operating assets as at June 30, 2002	17,621.228	16,409.605	1,211.623	(6.88%)

12.4. In future, the Authority will only allow capitalization of investment which has been prudently incurred. Commencing FY 2002-03, the Petitioner is directed to submit detailed justifications for any additions to the asset base on which return is sought.

12. OPERATING REVENUES:-

13.1 Gas Sales

13.1.1 Gas sales have been projected in the Petition to increase by 11.36%, from 206,967 MMCF to 230,486 MMCF, as indicated below:

	2000-2001	2001-2002	Difference	*Percentage Increase / (Decrease)*
Sales (MMCF)	206,967	230,486	23,519	11.36
Sales (Rs. Million)	25,429.961	31,666.997	6,237.036	24.53

13.1.2 On the basis of 12 month actuals, the following revised figures have been obtained from the Petitioner:

Volume in MMCF

	2001-2002 (Original)	2001-2002 (Revised)	Difference	*Percentage %*

				Increase/ (Decrease)
Sales Volume	230,486	234,419	3,933	1.7%

13.1.3 Increase in sales volume has resulted in an increase of Rs.556.423 Million in gross sales revenues.

Rs. in Million

	2001-2002 (Original)	2001-2002 (Revised)	Difference	*Percentage %* *Increase/ (Decrease)*
Gross Sales	31,666.997	32,223.420	556,423	1.76%

13.1.4 The Authority feels that actual / estimated gross sales value amounting to Rs. 32,223.420 Million is acceptable.

13.2 Late Payment Surcharge

13.2.1 The Petitioner has submitted a comparative analysis of late payment surcharge on the basis of 12 months actuals as indicated below:

Rupees in Million

	2000-2001	2001-2002	Difference	*Percentage %* *Increase/ (Decrease)*
Late Payment Surcharge	201.347	201.248	(0.099)	(0.05%)

The Petitioner further submits that late payment surcharge is charged on delayed payments from consumers. These late payments dent into the Petitioner's cash flow. Therefore the Petitioner ends up borrowing funds from financial institutions, resulting in increased financial charges. Under the loan covenants with ADB, however, financial charges are not allowed in the revenue requirement determination. Therefore, the Petitioner has excluded the income generated by late payment surcharge from the operating income.

13.2.2 CRCP is of the view that the late payment surcharge should be treated as operating profit because it is related with gas sale, which is the Petitioner's core business.

13.2.3 As stated above, the Federal Government has issued a policy guideline under the OGRA Ordinance stating that the Asian Development Bank Loan Agreement with the Petitioner is to be treated as the Policy of the Federal Government in relation to the tariff of the Petitioner. Section 8(a) of schedule 6 to the said Loan Agreement, states that the term "total operating revenues" means revenues from all sources related to operations, but excluding interest, dividends and other non-operating income. Besides, the late payment surcharge has always been treated as operating income in all previous determinations by the Federal Government. Furthermore, International Accounting Standard # 7, para 6, defines

"Operating Activities" as the "principal revenue producing activities of an enterprise and other activities that are not investing or financing activities."

Since the late payment surcharge is generated as a direct consequence of gas sales, which is the Petitioner principal revenue producing activity and is neither financing nor investing, therefore all revenues generated as a consequence of gas sales, including late payment surcharge has to be treated as operating income.

13.2.4 In view of the above, the Authority has decided to treat late payment surcharge as operating income.

13.2.5 Nevertheless, since non-timely recovery of bills has its own financial cost, the Petitioner is hereby directed to build a more efficient recovery system to ensure timely recovery of consumer gas bills.

13.3 Profits from Meter Manufacturing

14 The Petitioner has projected profits from meter manufacturing business at Rs. 29.834 Million as a non- operating income on the plea that it is not a regulated activity. As such, these profits have been excluded by the Petitioner from the calculations of revenue requirement. Furthermore, assets related to meter manufacturing have also been excluded from the net asset base.

15 The Authority has noted that under the ADB loan covenants, profit from meter manufacturing business is treated as operating income. Besides, the prevailing standard practice is that it is treated as part

of operating income. The Authority has obtained from the Petitioner the actual profits for 12 months which are stated to be Rs. 41.884 Million.

16 As a consequence of the addition of profit from meter manufacturing in the operating income, the revenue requirement of the Petitioner has decreased by Rs. 0.13 per MCF as indicated below:

Meter Manufacturing Profit **A**	**Meter Manufacturing Profit after grossing up (A x 1.05)** **B**	**Sales Volume MCF** **C**	**Rs. Per MCF Value (B/C)** **D**
Rs. 41.884 M	Rs. 43.978 M	234.419	Rs. 0.19 per MCF

As a consequence of the addition of the profit from meter manufacturing, the meter manufacturing related assets have been added back in the net asset base, thereby increasing the revenue requirement as below:

Average Meter Manufacturing Assets **A**	**Return on Meter Assets (A x 17%)** **B**	**Sales Volume MCF** **C**	**Rs. Per MCF Value (B/C)** **D**
Rs. 79.02 M	Rs. 13.433 M	234.419	Rs 0.06 per MCF

The net impact of adding back the meter manufacturing division in operating activities comes to Rs. 0.13 per MCF, as follows:

Rs. Per MCF

Decrease in Revenue Requirement due to Meter Manufacturing Profit	0.19
Less : Increase in Revenue Requirement due to Meter Manufacturing Assets	0.06
Total decrease in Revenue Requirement	**0.13**

13. EXPENSES:-

14.1 Unaccounted for Gas

14.1.1 The Petitioner has projected UFG for FY 2001-02 at 7.75 % (19,363 MMCF), as against 8.36% (18,870 MMCF) during the previous year.

14.1.2 CRCP and Quality Advisors are of the view that UFG rate is very high and the Petitioner should bear the cost from its own profits instead of including it in the revenue requirement. They have suggested that the Authority should set UFG targets for the Petitioner, in order to bring them within the internationally acceptable norms. It has also been observed that even though the UFG in terms of percentage has reduced from 8.36% for FY 2000-01 to 7.65% for FY 2001-02, but has increased in terms of volume from 18,870 MMCF (FY 2000-01) to 19,420 MMCF (FY 2001-02).

14.1.3 The Authority has obtained the 12 month actuals from the Petitioner. Accordingly, UFG for the FY 2001-02 has been revised downward to 7.65 % (19,420 MMCF).

14.1.4 Nevertheless, virtually all interveners have taken issue with the high levels of UFG in the Petitioner's system. Keeping this in view, the Petitioner is hereby directed to endeavor to reduce the UFG progressively to below 6% in next three years, commencing from financial year 2002-03.

14.2 <u>Operating Expenses:</u>

14.2.1 The figures representing operating expenses that the Authority has obtained from the Petitioner is Rs 2,909.610 Million which is an increase of 14% from the previous financial year as follows: Rupees in Million

	2000-2001	2001-2002	Difference	*Percentage %* *Increase/ (Decrease)*
Transmission and Distribution Cost	2,552.315	2,909.610	357.295	14

14.2.2 Various components of operating cost are discussed in the following paragraphs:

14.3 Salaries and Wages

14.3.1 The salaries and wages constitute 83% of operating cost, which has registered an increase of 18% from the previous year, as indicated below:

Rupees in Million

	2000-2001	2001-2002	Difference	*Percentage %* *Increase/ (Decrease)*
Salaries and Wages	2,072.947	2,446.309	373.362	18

14.3.2 APTMA is of the view that the operating cost, being 9.13% of sales, is on the high side and must be compared with similar utilities in other parts of the world. APTMA suggests that the increase in operating costs being claimed by the Petitioner is primarily owed to the inefficient practices being followed by it.

14.3.3 CRCP has observed that any salary increase must be commensurate with prevailing market conditions. Increase in salaries and wages by 18% in FY 2001-02 is very high against the prevailing inflation rate of 4%. CRCP suggests that any increase in salaries and wages should be directly related to increased productivity both in case of executives and unionized staff.

14.3.4 The Authority has noted that the impact of the proposed CBA agreement and that of the compensatory package for executives on revenue requirement is Rs. 1.67 per MCF.

14.3.5 The Authority directs that any revision in the compensatory package to executives should be directly related to productivity gains and prevailing market conditions and rightsizing.

14.3.6 The Authority has noted that the Petitioner has made a provision of Rs. 90 Million in the salaries and wages head in respect of the proposed CBA Agreement to be effective from 1st January, 2002 which is still under negotiation. The Authority feels that in the past the Petitioner has been concluding agreements with the CBA without any rationale. Therefore, the provision made on this account for Rs. 90 Million during the financial year 2001-02 is disallowed.

14.3.7 The Authority directs that the CBA agreement with the Petitioner should be based inter alia, on the following principles:

a. Increase in productivity
b. Prevailing domestic inflation rate
c. Control on overtime expenditure
d. Control on abuse of medical facility
e. Rightsizing of the manpower

This will form the basis of the Authority's determination of the prudence of any cost incurred by the Petitioner under this head for the purpose of revenue requirement determinations. Any amount due for the financial year 2001-02 on account of CBA Agreement shall be adjusted in the revenue requirement for the financial year subsequent to which the agreement has actually been concluded.

14. Receivables & provision for doubtful debts

15.1 APTMA is of the view that trade debts at the end of the FY 2000-01 stood at Rs. 7,370 Million which were 30% of the company's net sales. In other words the receivables continue to remain uncollected for over four months. It suggests that by reducing the collection period to 30 days the company will have additional cash inflow to off set any future increase in rates.

15.2 The Petitioner has clarified that the total amount of receivables does not have any impact on the determination of revenue requirement, since the amount for receivables has already been accounted for in the income statement as part of sales revenue.

15.3 The Authority notes that the Petitioner's provision for bad trade debts is reasonably good. Nevertheless, there is always room for further improvement. Therefore, the Petitioner is directed to make concerted efforts to build a more efficient recovery system to recover the outstanding arrears from its defaulters.

15. Proceeds of Sale of LPG Business

16.1 The LPG operations of the Petitioner were discontinued last year as a consequence of the sale of the business to Caltex Oil Pakistan Limited under a bidding process organized by the Privatization Commission. The Petitioner has treated the proceeds of sale of LPG business of Rs. 489.470 Million as non-operating income. Consequently, its revenue requirement has increased proportionately with an impact of Rs. 2.24 per MCF in prescribed price. This was disallowed by the Federal Government in the previous year's determination.

16.2 The Authority has undertaken the determination of current year's revenue requirement on the basis of existing tariff regime, and in accordance with the decision taken by the Federal Government for the financial year 2000-01 in which the Petitioner's request for treatment of profit on the sale of LPG business as non-operating income was disallowed, the Authority rejects the same.

Standards for Design, Construction and Testing of Equipment

17.1 Dr. S. M. Bhutta of Quality Advisors representing the general public submits that the performance standards for design, construction and testing of equipment, based upon international practices need to be prescribed and implemented in order to ensure quality service. The need for establishing independent third party testing facilities has also been stressed.

17.2 APTMA is of the view that the operating performance standards for the Petitioner should be based on internationally acceptable standards adopted by gas utility companies around the world, to bring about enormous improvement in operations and reduction of wastage, inefficiency and corruption.

17.3 The Authority is in the process of developing technical standards to be notified in due course of time. Once prescribed, these standards will have to be followed by the Petitioner.

18. Gas Development Surcharge

18.1 APTMA is of the view that the proposed upward revision in the Prescribed Prices will ultimately be passed on to or recovered from the consumers. CRCP observes that the prescribed price increase will definitely affect consumer prices in the next financial year, as the Government is likely to increase the sale prices to retain the same level of GDS. Dr. S. M. Bhutta of Quality Advisors is of the opinion that GDS collected from the customers should only be used for gas development related activities and not for other purposes.

18.2 The Authority feels that the federal government may consider the interveners' views in respect of the gas development surcharge.

19. ORDER

19.1 In view of the forgoing, the Petitioner is hereby directed:

(i) to ensure prudency in its capital expenditure and starting from FY 2002-03 provide detailed justification of various additions to the asset base.

(ii) to progressively reduce the UFG to below 6%, within three years, commencing financial year 2002-03.

(iii) to conclude any agreement with CBA on the basis of the principles enunciated in paragraph 14.3.7 of this determination.

(iv) to relate the productivity gains and prevailing market conditions while undertaking revision in the compensatory package for the executives.

(v) to make concerted efforts to build a more efficient recovery system to ensure timely recovery of its bills and to make concerted efforts to recover the outstanding arrears from its defaulters.

i) For the reasons stated in the preceeding paragraphs, the Authority feels that the increase requested by the Petitioner is not justified. Instead, the revenue requirement of the Petitioner shows a surplus of Rs. 76.096 Million as against a shortfall of Rs. 1,177.634 Million claimed by the Petitioner. Hence, the current Prescribed Price of the Petitioner is hereby revised downwards w.e.f. 1st July, 2001 by Rs. 0.32 per MCF as per the attached worksheet and schedule of tariff (Appendix A and B respectively).

(Jawaid Inam) Vice Chairman		(Munir Ahmad) Chairman