



OIL AND GAS REGULATORY AUTHORITY ISLAMABAD

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ISLAMABAD

August 8, 2002
Case No. OGRA-6(2)-1/2002-I

REVENUE REQUIREMENT DETERMINATION

Petitioner

Sui Northern Gas Pipelines Limited

Interveners

1. Consumer Rights Commission of Pakistan
2. The Gharibwal Group
3. Bestway Cement Limited
4. Pak American Fertilizers (Private) Limited
5. Dawood Hercules Chemicals Limited
6. ICI Pakistan Limited
7. All Pakistan Pottery Manufacturing Association

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



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BACKGROUND

1. Sui Northern Gas Pipelines Limited, (Petitioner) is a public limited company incorporated in Pakistan under the Companies Act, 1913 and listed on Karachi, Lahore and Islamabad stock exchanges. The Petitioner is engaged in the business of construction and operation of transmission and distribution pipelines and sale of natural gas.
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. 10.55 per MCF in each category of consumers, to meet a net shortfall of Rs. 3,383 Million in its revenue requirements for the financial year 2001-2002, due to the following factors:
 - a. Increase in net asset base resulting in increased revenue requirement in order to maintain 17.5% return on Petitioner's average net fixed operating assets as required under the World Bank loan covenants.
 - b. Increase in wellhead prices of gas producers especially wellhead price of Sui Gas field.
 - c. Increase in operating costs.
3. To determine whether a prima facie case for consideration was made out, the Authority sought further information from the Petitioner. While submitting the further information, the Petitioner indicated that there had been changes in the projections contained in the Petition since these were based on the 6 monthly accounts. Projections for cost of gas and operating cost were reduced on the basis of 9 monthly accounts, resulting in reduced shortfall of Rs. 2,744 Million, thus reducing the requested increase to Rs.8.61 per MCF. The Petitioner submitted a revised Petition which was now based on 9 monthly accounts.
4. On the basis of the revised Petition submitted by the Petitioner, the Authority has decided that a prima facie case for evaluation exists and therefore admitted the Petition for consideration on May 28, 2002.



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5. Notice inviting comments on the Petition from all the consumers, general public, interested and affected parties was published on 21st June, 2002 in three English and one Urdu national dailies. The Authority received ten communications relating to the Petition, which were relevant to the subject matter. Seven of these communicators applied to intervene in the proceedings as parties, namely:
- i. Consumer Rights Commission of Pakistan
 - ii. The Gharibwal Group
 - iii. Bestway Cement Limited
 - iv. Pak American Fertilizers (Private) Limited
 - v. Dawood Hercules Chemicals Limited
 - vi. ICI Pakistan Limited
 - vii. All Pakistan Pottery Manufacturing Association

Their intervention requests were accepted by the Authority. 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 / interventions was published in newspapers on 11th July, 2002. The public hearing commenced on July 29, 2002 and continued for three days. Evidence in the proceedings was closed on July 31, 2002.

6. SALIENT FEATURES OF THE PETITION

- 6.1 The Petitioner has made the following submission in support of the Petition:
- 6.1.1 Under the provisions of the World Bank Loan Agreement, the Petitioner is eligible to an annual return of not less than 17.5% 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 should cater for the cost of gas at wellhead and operating cost, which is to be notified as the prescribed price for the Petitioner.
 - 6.1.2 The net operating fixed assets are projected to increase from Rs. 21,648 Million to Rs. 22,881 Million.



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- 6.1.3 Based on the average net operating fixed assets, required return at 17.5% is computed at Rs. 3,896 Million.
- 6.1.4 The net operating revenues are projected at Rs. 36,606 Million, breakup of which is as follows:

Particulars	Amount Rupees in Million
Sales at current tariff	35,104
Rental and Service charges	605
Surcharge and Interest on arrears	465
Amortization of deferred credit	314
Operating loss in LPG business	(3)
Gain on sale of LPG business	121
Net operating revenues	36,606

- 6.1.5 Petitioner sold its LPG business to Shell Gas (Private) Limited on October 15, 2001 with a gain of Rs. 191 Million. The consideration included Rs. 70.586 Million on account of extinguishments of LPG dealer deposits. This amount should be treated as Non-operating Income since the amount has no relationship with the rate base and rate of return allowed under World Bank loan no. 3252-Pak. Therefore, only Rs. 121 Million should be taken as operating income, for the purposes of revenue determination.
- 6.1.6. **Net operating expenses** have been projected at Rs. 35,454 Million, breakup of which is as follows:

Rupees in Million	
Particulars	Amount
Cost of gas sold	28,300
Operating cost	4,281
Depreciation	2,737
Worker participation fund	135
Zakat fund / donations	1
Net operating expenses	35,454



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6.1.7. Shortfall in the revenue requirement has been calculated at Rs. 2,744 Million, which stipulates an increase of Rs. 8.61 per MCF in Prescribed Price as detailed below:

Rupees in Million

Particulars	Amount
Net operating revenue	36,606
Net operating expenses	35,454
Return obtainable	1,152
Revenue requirement	3,896
Shortfall in revenue requirement	2,744

6.1.8 Based on the aforesaid submissions, an increase of Rs. 8.61 per MCF is required in the Prescribed Price.

7. WRITTEN SUBMISSIONS OF INTERVENERS AND RESPONSES THERETO

7.1 CONSUMER RIGHTS COMMISSION OF PAKISTAN (CRCP)

CRCP submits that:

7.1.1 It finds the Petition poorly drafted, lacking in sufficient analysis, and relevant details and based on unexamined assumptions. The Authority should kindly direct the company to present its data in a comprehensive form for meaningful and improved intervention.

7.1.2 It 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 Petitioner dispels 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 limits.

7.1.3 The entitlement of 17.5% fixed return on average net operating fixed assets should not be the sole criterion to meet the revenue shortfall. The



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Authority should require the Petitioner to meet certain performance standards / benchmarks in order to put a check on its increasing cost of service, which has increased due to inefficiency, mismanagement and insensitivity to consumer stakes.

- 7.1.4 Rate of return of 17.5% on net operating fixed assets benefits the Petitioner irrespective of the performance, whether it is good or bad.
- 7.1.5 Reduction in receivables projected by the Petitioner could be attributed to writeoffs of such receivables. The Petitioner may be directed to produce justification for such writeoffs.
- 7.1.6 Although UFG in terms of percentage has been reduced to 7.91% in FY 2001-02, however, it is still very high as compared to internationally acceptable standards. If UFG is reduced by 1%, it results in additional revenue for the Petitioner amounting to Rs. 400 Million. It is extremely unjust that the related inefficiency cost is being passed on to consumers.
- 7.1.7 With regard to increase in salaries, it is prayed that any increase in salary beyond the prevailing inflation rate should be borne by the Petitioner and must not be passed on to the consumers in the form of tariff increase.
- 7.1.8 Projected balance sheet on page 2 of the Petition shows Rs. 8,798 Million (2000-01) and Rs. 8,542 Million (Projected 2001-02) as Bad Debts (Book Debts). CRCP demands to know why the Petitioner extended loans and debts without any guarantee or security.
- 7.1.9 With regard to “consumer contribution”, the Petitioner should elaborate on the nature of this expense. The Petitioner should finance its projects through bank borrowings and by raising capital and consumer money should not be used for this purpose, or the consumers should be made shareholders of the company, if the Petitioner is to utilize such contributions for financing its projects.



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7.1.10 As regards late payment surcharge, it should be levied on all categories of consumers, and not only on the domestic consumers.

7.1.11 The Petitioner should undertake timely replacement of old and damaged equipment, which will result in savings for the Petitioner on account of repair and maintenance cost.

7.1.12 It is concerned with the huge amount of internally consumed gas and wants the Petitioner to provide justification for the same.

7.1.13 The Petitioner should provide the details of measures being adopted for educating consumers for which provision of Rs. 2 Million has been made.

7.1.14 Quality of service is an important parameter, which should be kept in view while considering the case for tariff increase. The Petitioner does not command confidence of its consumers at large due to its poor quality of service.

7.1.15 The Authority is also requested to consider following points:

i. Upstream petroleum industry should come under the purview of Oil and Gas Regulatory Authority.

ii. All stakeholders should be consulted before the notification of wellhead prices.

7.2. **RESPONSE OF THE PETITIONER**

7.2.1 The Petition contains sufficient financial data and backup information to properly analyze the Petition for tariff increase. The tariff application is also in conformity with the industry practices.

7.2.2 The remarks are general in nature and in complete disregard of the loan covenants agreed with the World Bank. It is submitted that the wellhead



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prices of gas and category wise consumer selling prices are fixed by GOP on which the Petitioner has no control.

- 7.2.3 The reduction in receivables is not due to any write off in FY 2001-2002. The Petitioner has made strenuous efforts in realizing gas bills arrears.
- 7.2.4 The transmission and distribution losses of gas have shown steady decline.

30.06.2000	9.81%
30.06.2001	8.87%
30.06.2002	7.91%

The above decline is result of concreted efforts made by the Petitioner under the directions of its Board of Directors.

- 7.2.5 The increase in salaries and wages is accounted for as under:

(Million Rupees)	
Agreement with CBA (subject to negotiation)	150
Restructured Salary Package of Executives	61
Annual Increment	53
Incremental Provision under 1AS-19	29
Impact of CLA, free gas facilities and others	16
Total	309
Less: Reduction in Over Time	58
Net Increase	251

The Petitioner has to ensure quality service to the consumers for which adequately remunerated work force is essential. The salary package for executives has been restructured on the basis of the findings of study on market based remuneration, conducted by M/s A.F. Ferguson, in order to bring the compensation level of its executives in conformity with market practices.

- 7.2.6 Book debts represent amounts recoverable from gas consumers and there is no element of loan, guarantee and/or security in it. It appears that



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CRCP have misconstrued the Book Debts as Bad Debts. Hence the inferences drawn are incorrect.

- 7.2.7 Provision of Rs. 251.28 Million was made for doubtful debts in FY 2000-2001 as against Rs 200 Millions projected in FY 2001-2002. The Petitioner has been able to reduce its trade debts based on persistent and strenuous efforts and doesn't include any write offs. The provision for doubtful debts is 0.41% of gross turnover, which when viewed in the context of more than 2 Million consumers is very nominal.
- 7.2.8 Under the existing policy directives, the prospective consumers contribute funds to partially meet the cost of providing gas to their premises. The amount thus received is shown as 'deferred credit' in the financial statements and does not constitute return to the Petitioner. This is in accordance with the international practices and by no stretch of imagination the consumer can be made a shareholder through cost sharing.
- 7.2.9 Late payment surcharge is levied on domestic consumers while interest is charged from industrial and commercial consumers who fail to pay gas bills within the stipulated time. Hence all categories of consumers are liable to financial charges as provided in pages 15 and 16 of the Petition.
- 7.2.10 Maintenance and repair charges include expenses on leakage rectification and other measures leading to reduction in UFG in FY 2001-02. The Petitioner is cognizant of the maintenance parameters as suggested by CRCP. It is the Petitioner's understanding that the Authority is in the process of formulating technical specifications of equipments and facilities and fixing various efficiency oriented benchmarks, which will be notified in due course of time.



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7.2.11 Free gas facility is availed only by the unionized staff under CBA Agreements and has been correctly reflected as cost element as per accounting practices.

7.2.12 The consumer education program addresses the issues of safety awareness, conservation of gas awareness, and benefits of using quality material/appliances. The program is launched through press advertisement, Radio, TV and special messages on gas bills.

7.2.13 The Petitioner is committed to provide quality consumer services. However due to large geographical spread and more than 2 Million consumers, any utility like the Petitioner will be receiving complaints. A complaint redressal system is in place and performance is regularly monitored at various levels within the Organization.

7.2.14 Since there is no increase in the consumer prices, CRCP's prayer has no force and may be rejected.

7.3 **THE GHARIBWAL GROUP**

7.3.1 The Gharibwal group prays that the 10% specific increase in gas prices for cement industry should be withdrawn and prices should be equated with the prices of furnace oil by allowing 10% differential between the two prices. It also requests that a reasonable discount be allowed to the wet process and small scale dry process cement units as they bear much higher cost of fuel as compared to large scale dry process cement plant.

7.4 **RESPONSE OF THE PETITIONER**

7.4.1 Sales price notification and fixing of consumer prices on BTU basis falls within the purview of the agencies other than the Petitioner and no comments can be offered in this regard

7.5 **BEST WAY CEMENT LIMITED**



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Bestway Cement submits:

- 7.5.1 That the Petitioner is not a licensee for purposes of section 8 of the Ordinance and therefore it has no right to file the Petition before the Authority for determination of its revenue requirement or the Prescribed Price. The Authority must, therefore, dismiss the Petition;
- 7.5.2 That the Authority has no power under the applicable law to determine the revenue requirement of the Petitioner or the Prescribed Price of natural gas until the Petitioner has been issued a license under the applicable law.
- 7.5.3 That the Authority has a statutory obligation under the applicable law to determine a reasonable rate of return for each licensee but the Authority has not yet determined the same. In the absence of such determination the Authority cannot, under the applicable law, determine Petitioner's revenue requirement or the Prescribed Price.
- 7.5.4 That the Authority has no quorum to carryout the hearing proceedings for determination of revenue requirement of the Petitioner for the FY 2001-2002, since section 4 (1) of the OGRA Ordinance provides that Chairman and two other members shall constitute a quorum for a meeting of the Authority requiring a decision by the Authority.
- 7.5.5 That the Authority has no power under the applicable law to condone any contravention or waive any requirement under any provision of the applicable law, including, without limitation, the requirement that only a licensee may file the Petition before the Authority for determination of revenue requirement and the Prescribed Price.
- 7.5.6 That the Petition pertains to a retrospective period, namely July 1, 2001 to June 30, 2002, and cannot be entertained or adjudicated upon by the Authority under the applicable law.



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- 7.5.7 That, without prejudice to the aforementioned submissions, the Petitioner's alleged shortfall in revenue requirements is not the consequence of prudent expenditure and capital investment. Therefore, Petitioner's request for an increase in the prescribed price of natural gas by an average of Rs. 8.61 per MCF (average of Rs.30.56 per HM³) to meet an alleged shortfall in revenue is neither legally nor economically sustainable. Revenue shortfall arising, inter alia, as a result of avoidable or imprudent expenses or investments must not be passed on to consumers. The Authority must, therefore, reject the Petitioner's request.
- 7.5.8 That, the assumed rate of return at 17.5 % is excessive and compares to 29.45 % return on equity.
- 7.5.9 That, UFG of 7.91% is too excessive and should be reduced to 5% of gas available for sale as a first step.
- 7.5.10 That, the Authority may review the Petitioner's manpower levels and excess salary costs should be deducted from the revenue shortfall.
- 7.5.11 That, the value of stores and spares is Rs. 700 Million for FY 2001-02 as compared to Rs. 201 Million for FY 2000-01. 127 days of stores and spares is currently being maintained. The Authority may consider only allowing 90 days inventory for local purchases and 180 days for foreign purchases.
- 7.5.12 That, the current natural gas tariff contains distortions including equating of interruptible supply to the cement industry with uninterrupted supply to other categories of consumers, the absence of any benefit for consumers with a more favorable load factor or a lower cost of service, the massive subsidization of the price of natural gas supplied to fertilizer manufacturers as feed stock, and the levy of the gas development surcharge, must be removed by the Authority and the natural gas tariff be rationalized.



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- 7.5.13 That, pursuant to the policy of the Government of Pakistan, the price of natural gas supplied to cement manufacturers shall always be a minimum of ten percent lower than the BTU equivalent price of furnace oil after taking into account the increase in heat consumption and loss of production / profit. The Authority is, therefore, requested to determine the correct formula and methodology to calculate the price of natural gas applicable to the cement industry pursuant to the federal government policy.
- 7.5.14 That the Petitioner only decided to convert its plant from fuel oil to natural gas based on government policy incentives specified in the above said paras.
- 7.5.15 Bestway also submits copies of correspondence highlighting policy guidelines of the Federal Government, which prompted it to convert its plant from fuel oil to natural gas, to the Authority.

7.6 **RESPONSE OF THE PETITIONER**

- 7.6.1 The Petitioner is a deemed licensee under section 45 of the OGRA Ordinance read with Rule 33 of the Licensing Rules, 2002. The Petitioner has also applied for an integrated license after paying prescribed fee and completing other formalities. Notwithstanding the foregoing, the Petitioner has been guaranteed a ROR of 17.5%, approved by the Cabinet in 1990.
- 7.6.2 The Petitioner as a prudent operator is following the accepted Industrial Practices and Standards in the conduct of its business. The assertions of the Intervener are misconceived.
- 7.6.3 The Petitioner as a prudent operator is efficiently running its network, improving consumer services and has brought down its UFG in the FY 2001-02.



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7.7. PAK AMERICAN FERTILIZERS (PRIVATE) LIMITED

Pak American Fertilizer submits that:

7.7.1 It is a new investment and that the plant came into commercial production on November 19, 1999. As such the tariff of Natural Gas being supplied as feed stock is fixed for the initial 10 years of operation vide ECC's decision No. CEC-90/9/88 dated March 09, 1988. Any change in tariff for the gas used as feed stock would contravene the Government's Policy of providing incentive to the fertilizer industry which has a huge capital outlay and is instrumental for providing self-sufficiency in food.

7.7.2 The gas for power generation is being charged on commercial rates, which is also very high. Frequent changes in the gas tariff have adversely affected the financial viability of their new project. Frequent change in tariff also affects the end price of the product.

7.7.3 Furthermore the GOP has revised the gas billing mode from volumetric basis to heating value basis w.e.f January, 2002. This has further enhanced PAFL's monthly gas bill by 14-15%. Pak-American Fertilizers has been deprived of the concession allowed by ECC under Fertilizer policy. This also clearly contravenes the GOP's Fertilizer policy.

7.8. RESPONSE OF THE PETITIONER

7.8.1 Since there is no increase in the consumer prices, the submissions made by the intervener are not relevant. Even otherwise the fixing of consumer prices on BTU basis falls within the purview of the agencies other than the Petitioner and no comments can be offered in this regard.

7.9. DAWOOD HERCULES CHEMICALS LIMITED

7.9.1 Dawood Hercules Chemicals Limited prays that it is manufacturing urea fertilizer and is one of the largest customers of the Petitioner. It is a



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capital-intensive industry and its profitability is heavily dependent on full capacity utilization.

7.9.2 For last many years, it has not been able to achieve 100% capacity because of the curtailment/ stoppage of gas supply. This has badly affected the profitability of the Dawood Hercules Chemicals Limited and its competitive ability. Fertilizer producers fed by Mari Gas are supplied gas throughout the year while the Petitioner cuts them off for long periods during the winter months. This phenomenon puts them in a disadvantageous position vis a vis the producers on the Mari Fields. This is not in line with the provisions of clause 2.5 of the Fertilizer Policy-2001, which assures equal treatment with all fertilizer producers.

7.10. RESPONSE OF THE PETITIONER

7.10.1 The comparison between Mari gas and the Petitioner is not applicable. Even otherwise the gas supply through Mari system and that transmitted through the Petitioner cannot be equitably compared. The issues regarding the Fertilizer Policy applicability do not relate to Petitioner as a licensee under OGRA Ordinance 2002.

7.10.2 The interruption in supply of gas to Dawood Hercules Chemical Limited and other fertilizer companies was made as per directives of Government of Pakistan received through Director General (Gas) letter No.NG(I)-7(158)LS/2001 dated 6th December 2001 and 2nd February 2002 and Ministry of Industries & Production letter No.10(2)/2001-P&D.II(Pt) dated 11th February 2002. As per Petitioner's understanding these interruptions were made in accordance with the gas supply and demand management programme 2001-02 to meet the peak winter loads of domestic and other consumers.

7.11 ICI PAKISTAN LIMITED



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ICI submits that:

- 7.11.1 The Gas Tariff or Pricing Rules of the Authority have not yet been approved. In the absence of such Rules, it is not possible to ascertain whether the Petition conforms to the legal requirements or other technical and financial standards under the applicable law, and therefore any determination made hereunder by the Authority could be subject to legal implications.
- 7.11.2 It has the apprehension that an increase in prescribed price, which would consequently result in decrease in Gas Development Surcharge, would prompt the Government to increase consumer prices to make up for the short fall in GDS.
- 7.11.3 GDS and other government takes should be reduced, since the Government's share in overall revenue earned by the Petitioner is 54%, out of which 14% represents GDS. Also, the Government should give out a clear policy with respect to charging the GDS especially specifying the upper limit of GDS on Rupees /MCF basis and justify any increase sought by it. The GDS collected per MCF for the year 2001-02 should not exceed the GDS collected in the last fiscal year (2000-01).
- 7.11.4 The relief being sought by the Petitioner should be examined very carefully because it is widely believed that cost plus mechanisms for revenue determination lead towards inefficiencies in the utility operations as there is no incentive or penalty to reduce the expenses. The Authority must analyze all such expenses that have a bearing on consumer tariff with prudent utility practices and disallow the excess expenses incurred.
- 7.11.5 The Petitioner should not be given an increase of more than Rs. 4.37/MCF as it can generate sufficient additional saving through curtailment of expenditures.



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- 7.11.6 The Petitioner's ROR should be reduced to 15.16%.
- 7.11.7 The Petitioner should be directed to reduce UFG from 7.9% to 5% in accordance with international practices, which will result in savings of Rs. 874 Million.
- 7.11.8 The Petitioner is installing new lines and compressors thereby incurring high capital cost of Rs. 13 billion in the next three years. The major investment is concentrated in the section between Bhong and Multan. The additional capacity of this section is shown to be 1380 MMCFD in the year 2004. The company would have five parallel loop lines in this region that would be of 16", 18", 24", 30" and the new planned 36". The combination of these lines should result in the combined capacity in excess of 1500 MMCFD, if properly operated. The Authority is requested to ask the Petitioner to submit its detailed working of the estimated capacity throughout the system. It appears that the Petitioner may have used the derated capacity of the older loop lines where the lines are not operating at their optimum capacity due to improper maintenance practices e.g. lines not being cleaned or pigged, and lines not being operated at their optimal pressure ratings.
- 7.11.9 The Authority should verify the underlying assumptions used by the Petitioner to arrive at this expansion program and ensure that the optimal combination of line and compression additions is being implemented. Furthermore, it also appeared from the Petitioner's presentation that Bhong-Multan Section would remain under utilized after year 2005 as lesser gas supply would be available from South to meet the demand in the North. The import of gas from Turkmenistan is expected to deliver gas near Multan, therefore, the infrastructure additions between Bhong-Multan would become redundant.



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7.11.10 It has concerns over these un-optimal expansions as the investments made by the Petitioner are ultimately recovered from consumers in the form of prescribed prices which allow for recovery of the capital expenditures through depreciation and return on assets (to cover the financial charges). The consumers should not be made to pay for the infrastructure not in use, and therefore in future the Authority should use the value of only those assets which are optimally utilized to determine the return allowed to the Petitioner as part of its prescribed price.

7.12 RESPONSE OF THE PETITIONER

7.12.1 Petition has been filed by the Petitioner under the OGRA Ordinance, 2002. The Authority is competent to decide whether it can assess revenue requirement in absence of tariff rules.

7.12.2 The apprehensions regarding increase in consumer prices are unfounded and do not relate to the Petitioner.

7.12.3 The observation regarding the mechanism of revenue determination is unfounded and premature and is not related to the Petitioner.

7.12.4 Suggestion regarding maximum increase of Rs. 4.37 per MCF in prescribed prices is suggestive and judgmental. The Petitioner 's request is supported by sound financial data and covenanted rate of return, and conforms to industry norms of Pakistan.

7.13 ALL PAKISTAN POTTERY MANUFACTURING ASSOCIATION

7.12 Pakistan Pottery Manufacturing Association is concerned with the high levels of gas thefts in Gujrat region, which is affecting the pottery industry in the area. They pray that steps should be taken in order to curb this menace.

7.14 RESPONSE OF THE PETITIONER



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7.14.1 The intervention request does not fall under Section 9 of the OGRA Ordinance 2002 as the complaint pertains to gas theft and pilferage for which the Authority has to prescribe the regulations under Rule 30 of Natural Gas Regulatory Authority (Licencing) Rules 2002.

7.14.2 Notwithstanding the above position, it is submitted that a few complaints were received from various sources regarding gas theft by pottery manufacturers in Gujrat. After receipt of complaints, a mobile testing lab was sent to Gujrat for checking flow proving of all active industrial consumer meters. Total 133 meters were tested /flow proved in the presence of consumers. The status of violation cases detected is as under:

- i. Confirm tempering cases 10 Nos
- ii. Suspected meter tempering cases 06 Nos
- iii. Un-authorized pressure enhancement cases 03 cases

The Petitioner has also obtained authenticated electricity consumption record from WAPDA against 16 industrial units to examine comparison of gas and electricity consumption. We have noticed that in five cases the gas consumption is less than the normal ratio of parameters i.e. 3 times the electricity consumption.

7.14.3 The Petitioner has decided to send notices to such consumers for imposition of detection bills after obtaining legal opinion and completing other formalities in this regard.

8. COMMENTS

8.1 DR. S M BHUTTA

8.1.1 Dr. S.M.Bhutta is of the view that technical benchmarks for the utility companies should be established and requests the Authority that the private sector organizations be allowed to test the Petitioner's facilities. He also requests that the utility should make changes in the SCADA system, so that it can also monitor the BTU value of the gas.



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8.2 RESPONSE OF THE PETITIONER

8.2.1 Dr. Engr. S. M. Bhutta is not an aggrieved person under Section 9 of the Oil & Gas Regulatory Authority Ordinance 2002. Furthermore, the comments are mostly of general and suggestive nature.

8.2.2 However, the Petitioner submits that it is complying with the API, AGA and other internationally recognized standards in respect of pipelines, compression, metering and other facilities. In addition to Petitioner's in-house quality control department, the services of 3rd party inspectors and consultants are also hired to assure compliance of the technical standards.

8.3 ASAD SIDDIQUI

8.3.1 Mr. Asad Siddiqui suggests that:

- i. Acceptable tolerable levels of UFG should be established for the Petitioner.
- ii. Depreciation policies should be in accordance with the international practices.
- iii. Under utilized parts of the Petitioner's system should be excluded from the rate base until such time they attain certain specified capacity.

8.3.2 The objections of Mr. Siddiqui are as follows:

- i. Provision for doubtful debts should not be allowed, on the grounds that the Petitioner holds security deposits from the customers equal to three months aggregate consumption at prevailing rates.
- ii. Rate of return allowed to the Petitioner is too high as compared to the prevailing interest rates.



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- iii. Late payment surcharge should be treated as non operating income

8.4 **RESPONSE OF THE PETITIONER**

- 8.4.1 It is the Petitioner's understanding that the Authority would be setting appropriate benchmarks for UFG in due course of time.
- 8.4.2 In gas industry, the assets are depreciated on the basis of lower of estimated useful lives of relevant assets and the time the reserves of the related gas fields are likely to be depleted. Viewed in this context the depreciation rate of 6% was fixed under loan agreement with the World Bank in 1990. Sui, Pirkoh and Loti fields are depleting and as such the depreciation rate determined in 1990 was realistic. Furthermore, if the rate of depreciation is reduced, the rate base would increase and consequently the return in absolute terms would be higher. Resultantly, the cost of service would remain unchanged even if, as suggested, the reduced rate of depreciation were applied.
- 8.4.3 Transmission and Distribution capacity is created to meet the projected gas demands and supply with the flexibility to meet the seasonal variations particularly during winter. The Petitioner has been selling all the gas which has been made available to it and as such there is not excess capacity.
- 8.4.4 Provision for doubtful debts amounting to Rs. 200 million has been estimated and claimed in the tariff application, which is 0.4% of the total turnover for FY 2001-02. The provision is nominal as compared to the turnover and the number of debtors, particularly about 2 million domestic consumers who have nominal security deposit with the Petitioner. The Petitioner has accelerated its disconnection efforts by



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deputing special teams so as to minimize debt irrecoverability. It is submitted that the provision for doubtful debts is a normal business expenditure, which is admissible for revenue requirements.

8.4.5 The present rate of return postulates reasonable return to the shareholders, which on the basis of financial criteria, approved by the ECC for Petitioner's Project-VI, was assumed to be 20%. However, due to substantial increase in the borrowing costs and other aggravating circumstances, the shareholders could not be paid cash dividend from FY 1992-93 through FY 1999-2000. With the restructuring of the Petitioner's financial statements and lower interest rates, the shareholders were enabled to get 17% cash dividend in FY 2000-01. It is trite fact that the industry should be consistently able to attract sufficient capital to be self-sustaining so as to continue to provide the goods and services that consumers desire. The reasonableness of any rate of return will have to consider this aspect, failing which investments will not be forthcoming for system expansion required to receive and transmit gas from new sources/fields. Keeping in view the above rationale, both the gas companies have approached Government of Pakistan to adjust the rate base by including Capital Work in Progress and Working Capital.

8.5 PLANNING AND DEVELOPMENT DIVISION, GOVERNMENT OF PAKISTAN

8.5.1 Planning and Development Division, Government of Pakistan, prays that:

1. i. Gas prices for feed stocks should not be subsidized
2. ii. Subsidy of 1st tier of domestic consumers should not be passed on to the other tiers of domestic consumers
3. iii. Petitioner should ensure recovery of its arrears from its defaulters



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4. iv. Petitioner should define an action plan to reduce UFG.
5. v. A transparent system for approval and monitoring of development projects needs to be adopted by the Petitioner so that sound financial and economic social projects are implemented.

8.6 RESPONSE OF THE PETITIONER

6. The Petitioner did not enter any response to the comments made by the Planning and Development Division in the Government of Pakistan.

9. POINTS CONSIDERED DURING THE PROCEEDINGS

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

- a. Legal issues relating to the Authority's competence to consider the Petition.
- b. Operating fixed assets
- c. Operating revenues
- d. Operating expenses
- e. LPG dealer deposits
- f. Unaccounted for gas
- g. Gas Development Surcharge
- h. Rate of Return on assets
- i. Receivables and Provision for Doubtful Debts
- j. Prescribed prices for cement industry

9.1 Legal Issues

- 9.1.1 It has been argued by Bestway Cement Limited that Section 8 of the OGRA Ordinance, whereby the Authority is empowered to determine the total revenue requirement of a



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licensee for natural gas and the sale of natural gas to a retail consumer for natural gas and on that basis advise the Federal Government the prescribed price of natural gas for each category of retail consumer of that licensee, does not apply to the Petitioner. Bestway Cement Limited argues that Section 2 defines “licensee” as being the grantee or holder of a license granted under the Ordinance and that the Petitioner is not a licensee within the meaning ascribed to that term under the Ordinance.

- 9.1.2 In this regard, Section 45 of the Ordinance is relevant, which provides that all persons lawfully carrying on regulated activities immediately before the commencement of this Ordinance shall be deemed to be validly carrying on such regulated activities pursuant to this Ordinance. This provision is applicable notwithstanding anything contained in the Ordinance including the requirement to hold a license under Section 23. Sub Section (1)(b) of Section 45 provides that all persons who are undertaking the transmission, distribution or sale of natural gas at the time of commencement of the Ordinance, may carry on their activities but may do so only on such terms and conditions as are applicable to them pursuant to this Ordinance and the Rules, subject to the condition that they shall apply for license in accordance with the relevant rules.
- 9.1.3 The Licensing Rules are the relevant rules in this regard and these provide that all existing companies carrying on regulated activities shall apply for a license within one month of the commencement of these rules and all such companies shall be deemed to be licensed under the Ordinance and Rules to carry on regulated activities on the terms and conditions applicable to them on the date these Rules come into force and until such time as the Authority has made its final determination on their application. Since the Petitioner has duly applied for a license, within one month of the commencement of the Licensing Rules, it is deemed to be a licensee under Rule 33 in addition to being protected under Section 45 of the Ordinance. Hence, the Authority is not persuaded by the objection raised by Bestway Cement Limited.
- 9.1.4 It has been submitted by Bestway Cement Limited that the term “tariff” has been defined under Section 2(1)(xxxix) as meaning “subject to policy guidelines, a schedule or



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rate determined or approved by the Authority in accordance with the Rules". Since no Rules are notified as yet, therefore, the Authority has no power to determine the tariff.

9.1.5 As discussed above, the Petitioner is now required to follow the terms and conditions of license specified in the OGRA Ordinance. Therefore, it has no recourse other than to plead a case for tariff increase in relation to its prescribed price before the Authority, all other laws relating to this area having ceased to have effect upon the promulgation of the OGRA Ordinance. If it is argued that the Petitioner cannot, in the absence of the rules, plead its case before the Authority, the Petitioner would be left without any remedy. On this point alone the relevant provisions of the OGRA Ordinance can not be strictly or narrowly construed as against the Petitioner. In any event, rules to be prescribed under the Ordinance necessarily have to be prescribed after the coming into force of the Ordinance. Thus resulting in a period of time during which the Ordinance itself is applicable but no rules are in the field. This period is particularly long in the instant case since a long drawn consultation process is being undertaken to ensure transparency in the prescribing of the tariff rules. During this intervening period the Petitioner's business has to carry on and hence the instant petition. The Authority feels that looking at the provisions of the Ordinance as a whole, particularly the provisions relating to the transitional period between the old regulation and regulatory oversight by the Authority, it would defeat the purposes of the Ordinance if it is held that whereas only the Authority is empowered to determine and notify the prescribed price of the Petitioner, the Petitioner is not entitled to seek a revision in its prescribed price by filing a case before the Authority. The remaining issue has been discussed above in detail and this issue is disposed of accordingly.

9.1.6 Bestway Cement Limited has also raised an objection that the Authority has not determined a rate of return for the Petitioner under Section 6(2)(t) of the OGRA Ordinance. The Intervener submits that this is a statutory duty imposed on the Authority and that the Authority has not been empowered to waive or condone contravention of statutory requirements imposed by the Ordinance.



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- 9.1.7 As stated in paragraph 9.3.8 below, the Authority has determined a rate of return in terms of Section 6(2)(t) of the OGRA Ordinance and thus discharged the statutory duty imposed on it. In this view, the question of waiver or condonation of statutory requirements does not arise in the instant case.
- 9.1.8 Bestway Cement Limited has also submitted that the Petition pertains to a retrospective period and therefore it cannot be entertained or adjudicated upon by the Authority.
- 9.1.9 The Authority feels that it cannot be said that the petition pertains to a retrospective increase in that the Petitioner's case is for an estimate of its total revenue requirement. As specified in Section 8 of the OGRA Ordinance the Petitioner would come back to the Authority for a review of its total revenue requirement once these estimates are actualized based on the audited accounts of the Petitioner. As Section 8(2) of the Ordinance expressly envisages, such an exercise would necessarily have to be retrospectively applicable, therefore, the objection raised by the Intervener is not accepted.
- 9.1.10 Bestway Cement Limited has also raised an objection relating to the quorum for meetings of the Authority. It submits that, Section 4(1) provides that the Chairman and two other members shall constitute a quorum for a meeting of the Authority requiring a decision by the Authority. The instant proceedings are being held by the Chairman and one member. The third member cannot participate due to non-availability of any other member and therefore the quorum of the Authority is not complete. The intervener cited several cases from England in support of its contention. However, no oral arguments were advanced by the Intervener in support of its contention that the cited cases were relevant to the issue at hand in the instant case.
- 9.1.11 The Authority has carefully examined the matter, particularly with reference to Sub-Section (4) of Section 4 of the Ordinance, which is reproduced below:

The case law cited by the Intervener is mostly irrelevant as it does not address the issue in the instant case, viz, can the Authority conduct its business in a situation where the Authority only has two members in its ranks. Only one very



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old case cited by the Intervener, namely New Haven Local Board v New Haven School Board, which is an 1885 decision of the English Court of Appeal, is based on facts which are similar to the instant case. It is interesting to note that the Intervener's contentions are supported by the decision of the High Court in the cited case but this decision was reversed by the Court of Appeal. Unfortunately, the majority in the Court of Appeal did not directly address the issue at hand and hence, their decision is not useful for the purposes of determining the matter.

9.1.12 There is no doubt that the quorum of the Authority for holding meetings requiring a decision is three. However, the lack of quorum arises solely due to the fact that there are vacancies in the Authority in that two members have not been appointed by the Government of Pakistan. Hence, the Authority feels that in the presence of clear statutory cover in the form of the Sub-Section (4) of Section 4, these proceedings of the Authority are not invalid since the invalidity arises only by reason of a vacancy in the Authority.

9.2 Operating Fixed Assets

9.2.1 The Petitioner is projecting its net operating fixed assets at Rs. 22,881 Million with an addition of Rs. 4,157 Million during FY 2001-2002 as follows:

	Amount Rs. In Million
Net Fixed Assets as at 30th June 2001	
Owned assets	24,718
Leased assets	224
Advances for plots	102
	25,044
Additions during the year	4,157
	29,201
Less: Depreciation during the year	2,737
	26,464
Less: Assets created from deferred credit	3,576
	22,888
Less: Written down value of LPG assets disposed of during the year	7
Net Fixed Assets as at 30th June 2002	22,881
Proposed additions in fixed assets	



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	Rs. In Million
Distribution development	1,300
Transmission SCADA	150
Plant & machinery, transport, furniture, electrical appliances, CP systems, loose tools etc	250
Chenab river crossing	85
6 miles of 24 inch dia pipeline Sui - MP - 6	90
68 km of 8 inch dia pipeline Sakhkot - Swat	275
Infrastructure Development Plan	
<i>Phase - I</i>	
13 miles of 36 inch dia Pipeline A3 - A4	467
Indus river crossing at Guddu	95
<i>Phase - II</i>	
13.82 miles of 36 inch dia Pipeline AC6 - AV29	481
22.78 miles of 36 inch dia Pipeline AV7 - AV3	734
Construction equipment	100
Borrowing cost capitalized	130
Total Additions during the year	4,157

9.2.2 Bestway Cement is of the view that the increase in Prescribed Price requested by the Petitioner is owed to imprudent capital expenditure.

9.2.3 ICI is also of the view that the capital expenditure program of the Petitioner may not be prudent, particularly because:

- The Petitioner could have saved money by using derated capacity of old loop lines, which are not operating at their optimum capacity due to lack of maintenance.
- With import of gas from Turkmanistan, expansion in the Bhong Multan section would become redundant.

9.2.4 The Petitioner has submitted that it being a prudent operator is following the accepted Industrial Practices and Standards in the conduct of its business and that Transmission and Distribution capacity is created to meet the projected gas demand and supply with the flexibility to meet the seasonal variations particularly during winter.



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9.2.5 The Authority feels that only those assets, which would be commissioned by June 30, 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, Indus river crossing is being disallowed for not being operational as at June 30, 2002. Hence, an amount of Rs. 95 Million has been disallowed from the total additions of Rs. 4,157 Million. Accordingly, the asset base has been revised thereby reducing it from Rs. 22,881 Million to Rs. 22,792 Million.

9.2.6 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 justification for such additions to the asset base on which return is sought.

9.3 Rate of Return on Assets

9.3.1 The Petitioner is calculating its revenue requirements on the basis of 17.5% return on average net fixed operating assets in accordance with covenants agreed with the World Bank Loan no. 3252-PAK.

9.3.2 ICI and Bestway Cement Limited have submitted that the rate of return corresponds to 24.95% return on equity for the Petitioner. The rate of return on assets should be a function of the weighted average cost of borrowings and a reasonable return on equity. They therefore consider 24.95% as return on equity to be high especially when the government has been able to bring inflation below 5% in the last few years. Also, over the same period the borrowing rates of banks have gone down in the wake of lower inflation in the country.

9.3.3 CRCP is of the view, that in presence of legal umbrella regarding 17.5 % guaranteed return, the Petitioner does not feel it obligatory to improve its efficiency and put a check on its increasing revenue requirements, which has increased due to its inefficiency, mismanagement and insensitivity to consumer stakes.

9.3.4 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.



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- 9.3.5 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. The Authority has commenced this consultation process.
- 9.3.6 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.
- 9.3.7 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.
- 9.3.8 In the meantime, the Authority has been advised by the Federal Government that the loan agreement between the Petitioner and World 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 structural and informal 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.

9.4 Operating Revenues:

9.4.1 Gas Sales



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9.4.1.1 Gas sales have been projected in the Petition to increase by 1.3 % from Rs 34,080 Million to Rs 34,534 Million as indicated below:

Comparative Analysis of Sales at prescribed prices

	2000-2001	2001-2002	Difference - Increase / (decrease)	Percentage
Sales - Rs. In Million	34,080	34,534	454	1.3%

Sales at Prescribed prices - for F/Y 2001-2002 and last two Years

Years	1999-2000	2000-2001	2001-2002
Sales Rs. In Million	25,550	34,080	34,534

9.4.1.2 On the basis of 9 months actual and 3 months projections, the following revised figures have been obtained from the Petitioner:

Revised Sales Revenue

	2001-2002 Original	2001-2002 Revised	Difference - Increase / (decrease)	Percentage
Sales Rs in Million	34,534	35,104	570	1.6%

9.4.1.3 Increase in sales is due to the increase in projected sales volume to power sector by 1.6%.

9.4.1.4 The Authority feels that the projected sales revenue amounting to Rs. 35,104 Million appears to be a reasonable assumption for the purposes of determining the Petitioner's revenue requirement.



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9.4.2 LPG business dealers deposit

9.4.2.1 The Petitioner sold its LPG business to Shell Gas LPG (Private) Limited on October 15, 2001 with a gain of Rs. 191 Million, in the following manner:

	Amount Rs. in Million
Sales Proceeds	142.000
Less: Privatization Commission's Fee	2.470
	139.530
Net sale proceeds received	139.530
Extinguishment of LPG dealers securities and advances	70.586
	210.116
Book Value on the date of transfer of Business	
Stores and spares	2.025
Advances for LPG purchases to PARCO and others	9.519
	11.544
Net proceeds against fixed assets	198.572
Less: Book value of assets as at October 15, 2001	
Original Cost	126.911
Accumulated Depreciation	(120.210)
	6.701
Gain on disposal of fixed assets	191.871

9.4.2.2 The Petitioner is of the view that the financial liability of Rs.70.586 Million due to extinguishment of LPG dealers securities and advances may be passed to it since it has no relationship with the rate base and rate of return allowed to the Petitioner under World Bank loan no. 3252-Pak. Therefore, only Rs. 121 Million are being taken as operating income by the Petitioner for its revenue determination.



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9.4.2.3 “LPG dealers deposits” relates to securities obtained from LPG dealers, in the normal course of business, which have been accumulated since LPG business was started by the Petitioner. Amount received by the Petitioner on this account were shown as a long-term liability in Petitioner’s balance sheet.

9.4.2.4 In October 2002, at the time of sale of LPG business to Shell Gas, the buyer paid the Petitioner sale proceeds of Rs.142 Million in addition to extinguishing the liability of dealer deposits amounting to Rs.70.586 Million.

9.4.2.5 International Accounting Standards define Operating Activities as “the principle revenue producing activities of the enterprise and other activities that are not investing or financing activities”.

9.4.2.6 Hence, the Authority is of the view that LPG dealer deposits qualify as operating income, since it is neither investing nor financing activity.

9.5 Operating Expenses

9.5.1 Cost of gas sold

9.5.1.1 The Petitioner has initially projected cost of gas sold to increase by 14 % from Rs. 24,849 Million to Rs 28,369 Million as indicated below:

Comparative Analysis of Cost of Gas Sold

	2000-2001	2001-2002	Difference - Increase / (decrease)	Percentage
Cost of Gas Sold . Rs. in Million	24,849	28,369	3,520	14%



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Cost of Gas sold - for F/Y 2001-2002 and last two Years

Years	1999-2000	2000-2001	2001-2002
Cost of Gas Sold . Rs. in Million	16,627	24,849	28,369

9.5.1.2 However, on the basis of 9 months actual and 3 months forecast, the cost of gas projections have been revised downward by the Petitioner to Rs. 28,300 as follows:

	2001-2002	2001-2002	Difference	Percentage
	Original	Revised	Increase / (decrease)	-
Cost of Gas - Rs. in Millions	28,369	28,300	(69)	0.2%
Rs. Per MCF	88.48	88.80		

9.5.1.3 CRCP is concerned with the high wellhead prices which it thinks are due to the monopoly of multinationals in petroleum sector. It is of the view that Government signs concession agreements with such exploration companies according to their wishes and determines the wellhead prices in accordance with their desires. Such wellhead price affects the revenue and income of utility like the Petitioner, which has direct bearing on consumer end tariff. CRCP believes that all sectors of petroleum should be in the purview of Authority so that all stakeholders including consumers may be consulted. This will also make the Authority more autonomous and helpful in protecting interest of all stakeholders.

9.5.1.4 The wellhead prices are fixed on the basis of Petroleum Concession Agreements negotiated between the President of Pakistan and petroleum exploration and production companies, at the time of grant of a concession for exploration and production of petroleum. The prices



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arising therefrom are duly notified in the official gazette. Having examined these notifications, the Authority is satisfied that the figure of Rs. 28,300 Million attributed by the Petitioner to cost of gas is based solely upon the aforesaid prices.

9.5.1.5 As stated above, the basis on which wellhead prices are fixed is entirely within the purview of the Government of Pakistan. Therefore the concerns expressed by interveners in relation to high wellhead prices, being outside the scope of the regulatory oversight of the Authority, can only be conveyed to the Government of Pakistan. The Authority feels that the Federal Government may consider the views of the interveners in respect of wellhead gas prices when fixing the basis of the same.

9.5.2 Unaccounted for gas losses

9.5.2.1 The Petitioner has projected UFG at 7.91% (27,381 MMSCF) as against 8.87% (30,001 MMSCF) during pervious year.

9.5.2.2 CRCP is of the view that UFG rate is very high as compared to Institute of Gas technology benchmark of 6%. It suggests that Authority should set UFG targets for the Petitioner, in order to bring it within the internationally acceptable norms .It is of the view that with every percentage reduction in UFG, the Petitioner will earn Rs. 415.73 Million. Bestway and ICI are of the view that the UFG should be brought down to 5% as a first step.

9.5.2.3 The Petitioner is of the view that, the UFG as compared to international standards is higher, because unlike the systems abroad, the Petitioner's system is expanding and UFG occurs while constructing new sections of the system.

9.5.2.4 Nevertheless a number of 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 level



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progressively to below 6% in the next three years, commencing financial year 2002-03.

9.5.3 Operating Cost

9.5.3.1 The Operating Cost has been projected by the Petitioner at Rs 4,281 Million, which is an increase of 11 % from the last financial year, as indicated below:

Comparative Analysis of Operating Cost

	2000-2001	2001-2002	Difference - Increase / (decrease)	Percentage
Operating Cost Rs. in Million	3,844	4,281	437	11%

Operating Cost - for F/Y 2001-2002 and last two Years

Years	1999-2000	2000-2001	2001-2002
Operating Cost Rs. in Million	3,581	3,844	4,281

9.5.3.2 Bestway Cement opposes the increase in operating cost and asks the management to adopt prudent procedures to reduce cost.

9.5.3.3 CRCP is of the view that substantial amount of maintenance cost will be reduced if the Petitioner adopts efficient policies of replacing old equipment and damaged lines.

9.5.3.4 Operating cost projections seem unreasonably high when compared with the nine months actual results. Therefore, Authority is of the view that Rs. 118 Million be disallowed.



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

9.5.4 Salaries and wages

9.5.4.1 Salaries and wages constitute 59% of the operating cost, which has registered an increase of 8.55% as indicated below:

7. Comparative Analysis of Salaries & Wages

8.	2000-2001	2001-2002	Difference – Increase / (decrease)	Percentage
9. Salaries & Wages Rs. In Million	10. 2,317	11. 2,515	12. 198	13. 8.55 %

14.

Salaries & Wages – for F/Y 2001-2002 and last two Years

Years	1999-2000	2000-2001	2001-2002
15. Salaries & Wages Rs. In Million	16. 2,335	17. 2,317	18. 2,515

-

9.5.4.2 CRCP is of the view that salaries, wages and benefits being costs of the Petitioner have direct bearing for the consumers. The amount under these heads has gradually increased from Rs. 2,335.466 million (1999-2000) to Rs. 2,567.000 million (2001-02) which is not in line with the rate of inflation (2.6%) in 2001-02. The salaries given to the staff by the Petitioner are very high when compared with other highly profitable departments. CRCP views any increase in salaries as very important provided it is commensurate with pressing needs of the market changes. CRCP stresses that any amount in excess of inflationary effect should be given to the



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Petitioner employees from the Petitioner's returns, and not from the pocket of consumers.

9.5.4.3 The Authority has noted that the Petitioner has made a provision of Rs. 150 Million in salaries and wages head in respect of the proposed CBA agreement, which is to be finalized. The Authority feels that in the past the Petitioner has been concluding agreements with CBA without any rationale. Therefore, the provision made on this account for Rs. 150 Million during the financial year is disallowed.

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

- Increase in the productivity and efficiency
- Prevailing domestic inflation rate
- Control on overtime expenditure
- Control on abuse of medical facility
- Rightsizing of the manpower

9.5.4.5 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 purposes of revenue determination.

9.5.4.6 Any amount due for the FY 2001-2002, on account of CBA agreement shall be adjusted in the revenue requirement for the financial year subsequent to the one for which the agreement has been actually concluded.

9.6 Gas Development Surcharge

9.6.1 Dr. Bhutta suggests that GDS should be collected from new customers, rather than the existing customers.



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- 9.6.2 ICI requests the Authority that GDS and other government taxes should be reduced, since, the government share in overall revenue earned by the Petitioner is 54% , out of which 14% represents GDS.
- 9.6.3 ICI also submits that the Government should give out a clear policy with respect to charging the GDS especially specifying the upper limit of GDS on Rs./MCF basis and justify any increase sought by it. The GDS collected per MCF for the year 2001-02 should not exceed the GDS collected in the last fiscal year (2000-01). ICI asks the Authority to convey to the Government that it should simplify its revenue collection mechanism and simplify all the royalties, taxes, excise duties, GDS and sales tax into one time tax as levying them at different stages results in multiple taxation. Government should give out a clear policy with respect to charging the GDS especially specifying the upper limit of GDS on Rs./MCF basis and justify any increase sought by it. Government should reduce the GDS per MCF for the year 2001-02 to the previous fiscal year level of Rs. 7.93/MCF.
- 9.6.4 The Authority feels that the federal government may consider the interveners' views in respect of the gas development surcharge.

9.7 Receivables & provision for doubtful debts

- 9.7.1 CRCP raises concerns about the huge amount of book debts of the Petitioner. CRCP is of the view that the Petitioner is reducing the amount of its book debts by providing huge writeoffs in the form of bad debts and provisions for doubtful debts.
- 9.7.2 Mr. Asad Siddiqui is of the view that provision for doubtful debts should not be allowed, on the grounds that the Petitioner holds security deposits from the customers equal to three months aggregate consumption at prevailing rates.
- 9.7.3 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.



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- 9.7.4 The Petitioner has made a provision for doubtful debts amounting to Rs 251.128 million which is 2.94 % of the total debts. This is being included by the Petitioner as part of its revenue requirement. Hence this portion of the receivables does impact on the Petitioner's prescribed price. The Authority is of the view that the provision for doubtful debts of 2.94% of the total trade debts is too high, keeping in view the prevalent operating environment. A figure of no more than 1.5% appears to be realistic in the prevailing conditions. Therefore, a provision for doubtful debts beyond 1.5% (Rs. 128.130 Million) of the total trade debts is being disallowed. This will reduce the revenue requirement of the Petitioner by Rs. 0.385 per Mcft.
- 9.7.5 The Petitioner is also directed 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.

9.8 Prescribed Prices for Cement Industry

- 9.8.1 Bestway Cement Limited has submitted that pursuant a the policy of the Government of Pakistan, the price of natural gas supplied to cement manufacturers shall always be a minimum of ten percent lower than the BTU equivalent price of furnace oil after taking into account the increase in heat consumption and loss of production / profit. The Authority has, therefore, been requested to determine the correct formula and methodology to calculate the price of natural gas applicable to the cement industry pursuant to the federal government policy.
- 9.8.2 Gharibwal group prays that the 10% specific increase in gas prices for the cement industry notified last year should be withdrawn and gas price should be equated with the price of furnace oil in accordance with the Government policy, by allowing 10% differential between the two prices. It also requests that a reasonable discount be allowed to the wet process and small scale dry process cement units as they bear much higher cost of fuel as compared to large scale dry process cement plants.



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9.8.3 The Policy of the Government referred to by the Interveners pertains to fixing of the sale price of gas for cement industry. This does not come within scope of the jurisdiction of the Authority. The Authority feels that under the OGRA Ordinance, its jurisdiction is restricted to the determination of the Petitioner's revenue requirement and Prescribed Prices for various categories of consumers. In any event, the Authority notes that the current Prescribed Price for the cement industry, which is within the scope of the Authority's jurisdiction, is Rs. 134.29 per MMBTU, whereas the equivalent fuel oil price (Ex Morgah Refinery) is Rs. 264.75 per MMBTU giving a differential margin of 97%. In this view, if the contention of the Interveners is accepted the Prescribed Price would have to be increased.

10 ORDER

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

- i) To ensure prudence in its capital expenditure and starting from FY 2002-03 provide detailed justification of various additions to the asset base.
- ii) To progressively reduce UFG to below 6%, within three years, starting financial year 2002-03.
- iii) To conclude agreement with CBA on the basis of principles enunciated in paragraph 9.5.4.4 of this determination.
- iv) 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.

10.2 For the reasons stated in the preceding paragraphs, the Authority feels that the increase requested by the Petitioner in its prescribed price amounting to Rs. 8.61 per MCF on the basis of its revenue shortfall of Rs. 2,744 million is not justified. The shortfall in the revenue requirement of the Petitioner is determined at Rs. 2,272 million which only justifies an increase of Rs. 7.13 per MCF over its current prescribed price. Hence the current prescribed price of the Petitioner is revised



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hereby upward with effect from July 1, 2001 by Rs. 7.13 per MCF as per the attached worksheet and schedule of tariff (Appendix A & B respectively).

(Jawaid Inam)
Vice Chairman

(Munir Ahmad)
Chairman