OIL AND GAS REGULATORY AUTHORITY
ISLAMABAD

24th October 2002

Case No. OGRA-6(2)-1/2002 (Final)

REVENUE REQUIREMENTS DETERMINATION (FINAL)
FINANCIAL YEAR 2001-02

Petitioner

Sui Northern Gas Pipelines Limited

Petition dated October 3, 2002

OIL AND GAS REGULATORY AUTHORITY

Chairman	Mr. Munir Ahmad
Vice Chairman and Member (Gas)	Mr. Jawaid Inam
Member (Finance)	Mr. Mahboob Elahi
Member (Oil)	Mr. Rashid Farooq

BACKGROUND

1. Sui Northern Gas Pipelines Limited, (Petitioner) is a public limited company incorporated in Pakistan under the Companies Ordinance, 1984 and listed on Karachi, Lahore and Islamabad stock exchanges. The Petitioner is engaged in the business of purification, construction and operation of transmission and distribution pipelines and sale of natural gas.

2. The Authority vide its decision dated August 8, 2002 had determined estimated revenue requirements of the Petitioner under section 8(1) of the Oil and Gas Regulatory Authority Ordinance, 2002. The Prescribed Price was increased on provisional basis by Rs. 25.30 per HM^3 (Rs. 7.13 per MCF) w.e.f. July 1, 2001.

3. The Petitioner, under section 8(2) of the Oil and Gas Regulatory Authority Ordinance 2002, filed a petition (the Petition) before the Authority on October 3, 2002 on the basis of annual accounts initialed by the Auditors, seeking, inter alia, further increase in prescribed prices of the Petitioner by Rs. 2.21 per HM^3 (Rs. 0.6222 per MCF) in each category of consumers, as earlier determined by the Authority in its decision dated August 8, 2002, to meet a net shortfall of Rs. 200.315 Million in its revenue requirements for the financial year 2001-2002.

4. To determine whether a prima facie case for consideration was made out, the Authority sought further information from the Petitioner.

5. On the basis of the information submitted by the Petitioner, the Authority held a pre-admission hearing on October 12, 2002, which was adjourned till October 14, 2002 at the request of the Petitioner.

6. In the meeting held on October 14, 2002 the Authority decided that a prima facie case for evaluation exists therefore, the Petition was admitted and the Petitioner was allowed to plead its case.

7. *SALIENT FEATURES OF THE PETITION*

7.1 The Petitioner has made the following submission in support of the Petition:

7.2 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 and operating cost, which is to be determined as the prescribed price for the Petitioner.

7.3 The net operating fixed assets have increased from Rs. 22,792 Million in provisional determination dated August 8, 2002 to Rs. 23,744 Million.

7.4 Based on the average net operating fixed assets, required return at 17.5% is computed at Rs. 3,971.793 Million.

7.5 The net operating revenues as per the Petition are Rs. 39,340.859 Million, breakup of which is as follows:

Rupees in Million

Particulars	**Per estimated revenue requirements determination dated August 8, 2002**	**Per Petition for final revenue requirement based on auditor's initialed accounts**
Sales at existing Prescribed Price	37,376	37,800.886
Rental and Service charges	605	585.016
Surcharge and Interest on arrears	465	436.826
Amortization of deferred credit	314	312.849
Operating loss in LPG business	(3)	(3.192)
Gain on sale of LPG business	192	191.871
Gain on sale of fixed assets	-	13.213
Other Operating Income	-	3.390
Net operating revenues	**38,949**	**39,340.859**

7.6 **Net operating expenses** are Rs. 35,569.381 Million, breakup of which is as follows:

RupeesinMillion

Particulars	**Per estimated revenue requirements determination dated August 8, 2002**	**Per Petition for final revenue requirement based on auditor's initialed accounts**
Cost of gas sold	28,300	28,549.844
Operating cost	3,890	4,062.814
Depreciation	2,734	2,751.201
Worker participation fund	135	150.530
Worker's Welfare Fund	-	39.193
Provision for diminution in the value of investment	-	15.799
Zakat fund / Donations	1	-
Net operating expenses	**35,060**	**35,569.381**

7.7 Shortfall in the revenue requirement has been calculated by the Petitioner at Rs. 200.315 Million, which stipulates an increase of Rs. 2.21 per HM^3 (Rs. 0.6222 per MCF) in the prescribed price over and above that allowed provisionally by the Authority on August 8, 2002 as compared below:

Rupees in Million

Sr. No.	**Particulars**	**Per estimated revenue requirements determination dated August 8, 2002**	**Per Petition for final revenue requirement based on auditor's initialed accounts**
(i)	Net Fixed Assets as at 1.7.2001	21,648	21,648.281
(ii)	Net Fixed Assets as at 30.6.2002	22,792	23,743.642
(iii)	Average Net Fixed Assets	22,220	22,695.962

(iv)	Revenue Requirements at 17.5%	3,889	3,971.793
(v)	Net Operating Revenue	38,949	39,340.859
(vi)	Net Operating Expense	35,060	35,569.381
(vii)	Return obtainable (v – vi)	3,889	3,771.478
(viii)	Shortfall in Revenue Requirement (iv-vii)	-	200.315

8. *POINTS CONSIDERED BY THE AUTHORITY*

The Authority considered the following points during the proceedings:

a. Operating Fixed Assets

b. Operating revenues

c. Operating expenses

d. Provision for diminution in the value of investment

Operating Fixed Assets

8.1 The Petitioner has valued its net operating fixed assets at Rs. 23,743.642 Million with an addition of Rs. 5,163.400 Million during FY 2001-2002.

Value of Net Fixed Asset in Operation as at June 30, 2002

Description *Rupees in million*	**Per estimated revenue requirements determination dated August 8, 2002**	**Per Petition for final revenue requirement based on auditor's initialed accounts**
Cost of fixed assets as at 1st July	44,111.578	44,111.578
Add: Additions during the year	4,062.000	5,163.400
Less: Deletions	(126.911)	(201.969)
	48,046.667	49,073.009
Less: Accumulated Depreciation	19,393.046	19,393.046
	28,653.621	29,679.963
Less: Depreciation during the year		
Depreciation for the year	2,733.970	2,742.801
Depreciation for assets transferred from lease assets	0	36.000
Less: Adjustment for fixed assets deleted during the year	(123.210)	(194.505)
Net depreciation for the year	2,610.760	2,584.296

	24,718.532	27,095.667
Asset subject to finance lease	224.600	102.200
Advance for land	101.674	78.181
	26,369.135	27,276.048
Less : Deferred credit for completed jobs		
Total as per balance sheet	3,877.215	3,980.851
Less: Work in Progress	(300.000)	(448.445)
	3,577.215	3,532.406
Net fixed assets in operation for rate base	22,791.920	23,743.642

Fixed Asset Additions During the Year

Description *Rupees in million*	**Per estimated revenue requirements determination dated August 8, 2002**	**Per Petition for final revenue requirement based on auditor's initialed accounts**
Transmission System	2,132.000	3,014.555
Distribution Development	1300.000	1,769.936
Others	630.000	378.909
	4,062.000	5,163.400

8.2 The additions in assets include 290 km of transmission mains, 877 km of distribution mains and 393 km of service lines. The transmission lines have been constructed under "Gas Infrastructure Development Plan" as approved in principle by the Cabinet on August 9, 2000 for bringing additional gas from new fields to the power units in and around Multan. Furthermore, during the year the Petitioner has given new connections to 123 industrial consumers, 2,402 commercial consumers and 102,804 domestic consumers.

8.3 The fixed assets except freehold land are stated at cost less accumulated depreciation. Freehold land is stated at cost. Depreciation is charged to profit & loss account on the straight line method so as to write off the cost of the asset over its estimated useful life. Transmission and distribution systems, meter and compressor stations and equipments are depreciated at annual rates in accordance with the terms of loan agreement (3252-Pak) with the World Bank. This agreement requires that the depreciation be charged at rate not less than 6% per annum of the average cost of such assets in operation.

8.4 Half years depreciation is charged on additions during the year. No depreciation is charged on the assets deleted during the year, except for assets transferred to executives under service rules where depreciation is charged until the date of executive's retirement.

8.5 The Authority accepts the valuation of Fixed Assets as verified by the Auditors in the initialed accounts.

8.6 In accordance with the earlier decision by the Authority contained in its decision dated August 8, 2002, the Petitioner must ensure prudency in its capital expenditure and starting from financial year 2002-03 provide detailed justification of various additions to the rate base.

Operating Revenues:

Gas Sales Revenues

8.7 Gas sales revenues have increased by 1.13% from the estimated sales as per the Determination dated August 8, 2002 for FY 2001-02. This increase is due to more volume of gas sold to power and industrial sector which have higher prescribed prices as compared to other categories of consumers as well reduction in gas sales to domestic consumers, per table below:

Description	Per estimated revenue requirements determination dated August 8, 2002 (HM^3)	Per Petition for final revenue requirement based on auditor's initialed accounts (HM^3)
Power - WAPDA	10,313,960	9,918,625
- KAPCO	7,625,283	8,729,475
- LIBERTY	3,298,514	3,447,353

- FKPCL	1,662,332	1,603,693
Power Sector Total	**22,900,089**	**23,699,146**
Fertilizer Sector	**11,546,842**	**11,481,743**
CEMENT	1,384,690	1,050,583
OTHERS - GENERAL INDUSTRIAL	23,215,372	24,045,001
- COMMERCIAL	4,434,580	4,380,539
- DOMESTIC	26,298,099	26,050,550
TOTAL SALES VOLUME	**89,779,672**	**90,707,562**
TOTAL SALES REVENUES (Rs. in Million)	**37,376**	**37,801**

8.8 The Authority accepts the sales revenue as verified by the Auditors in the initialed accounts.

Surcharge and Interest on Arrears of Gas Sales

8.9 The Petitioner in its Petition dated October 3, 2002 had claimed Surcharge and Interest on Arrears of Gas Sales amounting to Rs. 436.826 Million after netting off Rs. 69.519 Million, which is interest receivable from Heavy Mechanical complex (HMC).

8.10 The Petitioner was of the view that even after consistent follow up, it is unable to recover Rs. 69.519 Million interest due from Heavy Mechanical Complex (HMC) . HMC being a Governmental organization had been continuously defaulting in the payment of the principal amount as well as interest thereon. HMC has settled the payment of principal amount and now all arrears for gas purchase have been cleared on the understanding that interest amount of Rs. 69.519 Million will not be paid by it. Therefore, the amount has been adjusted against the operating income.

8.11 The Authority is of the view that netting off previous year arrears against the current income is a wrong accounting treatment and is against the generally accepted accounting principles. The Petitioner can claim this irrecoverable interest as provision for doubtful debts.

8.12 The Authority also observed that as per the contract of gas supply between the Petitioner and HMC, the Petitioner was to charge 1% above prevailing bank rate on outstanding balance of bills per month as Surcharge and Interest on gas sales arrears. However, in actual the Petitioner was charging HMC interest at the rate of 2% per month resulting in excess charge of Rs. 30.774 Million.

8.13 The Petitioner agreeing with the Authority's view point had subsequently reversed Rs. 69.519 Million previously netted off from the Income from Surcharge and Interest on gas sales arrears. Further more, the Petitioner

had also reversed Rs. 30.774 Million interest wrongly charged to HMC. through revised computation submitted on October 12, 2002.

8.14 In view of the above the Authority determines income from Surcharge and Interest of gas sales arrears at Rs. 475.570 Million as against Rs. 436.826 Million reflected in the auditor's initialed accounts thereby increasing operating revenues by Rs. 38.745 Million.

Interest on Gas Sales Arrears from WAPDA

8.15 The Petitioner is recognizing WAPDA's interest on gas sales arrears on receipt basis, which is against the accrual based revenue recognition policy of the Petitioner.

8.16 The Petitioner pleaded that WAPDA is continuously defaulting on its principal as well interest payments. Due to the nature and size of this consumer, it is not possible to exercise the option of disconnection. Therefore, it may be allowed to follow the receipt base policy in case of WAPDA. The Petitioner also cited example of CBR, where WAPDA is the only entity which is allowed to recognize Sales Tax on receipt basis.

8.17 The Authority accepts the Petitioner's plea and allows it to recognize WAPDA's interest on receipt basis, with the direction to take up the matter at appropriate forum for recovery of interest on gas bill arrears from WAPDA.

Other Income- Insurance Claim

8.18 The Petitioner has claimed Rs.44.954 Million on account of Insurance claims as non-operating income, consisting of Rs. 3.691 Million and Rs. 41.263 Million on account of marine claims and other claims respectively.

8.19 These other claims amounting to Rs. 41.263 Million pertain to consequential loss of profits due to rupture of pipelines, fire and loss of materials due to floods, for which the insurance premium is picked up as operating cost.

8.20 In view of the foregoing, the Authority holds that Other Insurance claim amounting to Rs. 41.263 Million does not qualify as non-operating income and be included in the operating income for the purpose of final revenue determination.

<u>Operating Expenses</u>

Operating Cost

8.21 The Operating Cost for the financial year 2001-02 are Rs. 4,062.814 Million, showing an increase of 4.44 % from operating cost as determined vide Authority's decision dated August 8, 2002, as indicated below:

Rupees in Million

Per estimated revenue requirements determination dated August 8, 2002	**Per Petition for final revenue requirement based on auditor's initialed accounts**	Difference – Increase / (decrease)	Percentage
3,890.000	4,062.814	172.814	4.44%

8.22 Major increase in operating cost is due to the inclusion of Rs. 150 Million provision on account of CBA agreement by the Petitioner, which was disallowed by this Authority in the decision, dated August 8, 2002, pending finalization of agreement.

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

8.24 **Salaries and wages**

Salaries and wages constitute 64.36% of the operating cost, which has registered an increase of 11.07% as indicated below:

Rupees in Million

Per estimated revenue requirements determination dated August 8, 2002	Per Petition for final revenue requirement based on auditor's initialed accounts	Difference – Increase / (decrease)	Percentage
2,365.000	**2,626.823**	**261.823**	**11.07 %**

8.25 The Petitioner has again included Rs. 150 Million provision for CBA agreement as operating expense.

8.26 Since the agreement has not been finalized todate, therefore, the provision of Rs. 150 Million is disallowed on the same grounds. 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 in which the agreement has been actually concluded in line with the principles laid down in decision dated August 8, 2002.

8.27 **Provision for Doubtful Debts**

In the Petition dated October 3, 2002, the Petitioner has claimed provision for doubtful debts amounting to Rs. 114.908 Million. As per decision dated August 8, 2002, the Petitioner was allowed to provide doubtful debts upto 1.5% of the total trade debts.

8.28 The Petitioner contended during the hearing that the interest now charged (Rs. 38.745 Million after adjustment per para 8.14 above) to HMC is doubtful of recovery since the said consumer is not only refusing to pay but also denying / disputing the liability. Accordingly, the provision for doubtful debts may be allowed by including the aforestated amount. In addition the Petitioner has claimed deduction of Rs.6.169 Million on account of provision for doubtful receivables. The aforestated claim is untenable as these receivables pertain to wrong supply of materials by foreign suppliers. However, keeping in view earlier decision of the Authority dated August 8, 2002, the provision for doubtful debts is restricted to Rs.140.01 Million for FY 2001-02, being 1.5% of the total trade debts. As directed earlier by the Authority vide its decision dated August 8, 2002 the Petitioner must make concerted efforts to build a more efficient recovery system and also put in place an effective disconnection mechanism so as to ensure timely recovery of its bills.

8.29 **Dormant jobs written off**

The Petitioner has claimed write off of dormant jobs amounting to Rs. 23.480 Million and charging it to the operating expense.

8.30 The Petitioner during the hearing pleaded that these jobs were undertaken on the specific directives of the Federal Government. Subsequent progress on these jobs was ceased again on the directives of the Government of Pakistan. As stoppage of these jobs was beyond the control of the Petitioner's management, therefore, it is justified in claiming these write offs as an operating expense.

8.31 The Petitioner submitted relevant Government letters as evidence.

8.32 The Petitioner also submitted that it is operationally and economically not possible to retrieve the pipelines already laid in those jobs, since their salvage value is less than their cost of retrieval.

8.33 The Authority after hearing the Petitioner's plea hereby decides to allow the write off only for the financial year 2001-02. No such write off will be allowed in future. Further more, the Authority directs the Petitioner that as a policy the Petitioner should always lay transmission lines or distribution spurs to a new town / area prior to laying distribution network.

Provision for diminution in value of investment

8.34 The Petitioner has claimed Rs. 15.799 Million as provision for diminution in value of investment made by it in the Civic Centre (Private) Limited.

8.35 The above-mentioned investment does not relate to the core business of the Petitioner and is not an operating activity.

8.36 Based on the above, the Authority holds that the provision in diminution in value of investment does not qualify as an operating expense.

8.37 **Unaccounted for gas losses (UFG)**

Initially the Petitioner projected UFG at 7.91% (27,381 MMSCF) as against 8.87 % (30,001 MMSCF) during the previous year. The Auditor's initialed accounts reflect UFG at 7.98% (27,914 MMSCF). The Petitioner has submitted in detail the efforts made to bring down UFG during FY 2001-02. The Authority after due consideration accepts the UFG at 7.98% as verified by the Auditors. The Authority reiterates its earlier direction to the Petitioner to progressively reduce the UFG to below 6% within three years, starting from the FY 2002-03.

Conclusion

8.38 In view of the above analyses and rejection of Petitioner's different claims as discussed in paras 8.14, 8.20, 8.26, 8.28 and 8.36 the Authority concludes that the Petitioner's Revenue Requirement as determined by the Authority on provisional basis in its orders dated August 8, 2002 are further reduced by Rs 30.374 Million thereby effecting a decrease in its average prescribed price by Rs.0.33 per HM3 over the provisional order dated August 8, 2002 per Annexure-A.

8.39 For the reasons stated in the preceding paragraphs, no person will be adversely affected, therefore, the Authority decides not to hold a public hearing.

9. ORDER

9.1 In view of the foregoing, 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 rate base.

ii) To always lay transmission lines or distribution spurs to a new town / area prior to laying distribution network

iii) To progressively reduce UFG to below 6%, within three years, starting financial year 2002-03.

iv) To conclude agreement with CBA on the basis of principles enunciated in the determination dated August 8, 2002 of this Authority.

v) To make concerted efforts to build a more efficient recovery system and put in place an effective disconnection mechanism so as to ensure timely recovery of its bills.

vi) To deposit the amount of development surcharge as determined on the basis of final Prescribed Price, with the Federal Government in accordance with the law, and compliance report be given to the Authority.

9.2 In pursuance of section 8(2) of the Ordinance, the Authority determines the total revenue requirement of the Petitioner at Rs. 3,971.793 Million for the financial year 2001-02. In order to achieve the afore-stated total revenue requirement, the Authority determines the prescribed prices of various categories of retail consumers for the financial year 2001-02 as per Annexure-B .

(Mahboob Elahi) Member (Finance)	(Rashid Farooq) Member (Oil)
(Jawaid Inam) Vice Chairman	(Munir Ahmad) Chairman