Case No. OGRA-6(2)-1(2)/2003

DETERMINATION OF ESTIMATED REVENUE REQUIREMENT FINANCIAL YEAR 2003-04

PETITIONER

SUI NORTHERN GAS PIPELINES LIMITED

Filing of Petition:	March 31, 2003
Admission for hearing:	April 4, 2003
Publication of notice for intervention and participation:	April 11, 2003
Publication of notice for public hearing:	April 30, 2003& May 1, 2003
Public hearing held:	May 16, 2003
Short order under section 8(1):	May 21, 2003

INTERVENERS

All Pakistan Textile Mills Association
Northern Power Generation Company Limited
Water and Power Development Authority (Power Privatization Organization)
Karachi Stock Exchange (Guarantee) Limited
Consumer Right Commission of Pakistan

PARTICIPANTS

Fauji Kabirwala Power Company Limited
Kot Addu Power Company Limited
Arif Habib Investment Management Limited
Qazi Muhammad Ilyas
Agha Mujeeb & Co.

OIL AND GAS REGULATORY AUTHORITY

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

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BACKGROUND

1 Sui Northern Gas Pipelines Limited, (Petitioner) is a public limited company incorporated in Pakistan under the Companies Ordinance, 1984 and 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 and transmission, distribution 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 January 15, 2003 which was subsequently revised by the Petitioner on March 31, 2003 seeking, inter alia, increase in its Prescribed Prices by Rs. 2.22 per MMBTU in each category of consumers, to meet a net shortfall of Rs. 989 million in its estimated revenue requirement for the financial year 2003-04, due to the following factors:

a. Projected increase in Wellhead gas prices during 2003-04.

b. Projected increase in net operating fixed assets, eligible for 17.5% covenanted rate of return.

3 To determine whether a prima facie case for consideration was made out, the Authority held a pre-admission hearing on April 4, 2003 and decided that a prima facie case for evaluation exists, therefore, the Petition was admitted and the Petitioner was allowed to plead its case.

4 Notice inviting comments on the Petition from all the consumers, general public, interested and affected persons was published on April 11, 2003 in the national press. The Authority received ten communications relating to the Petition, which were relevant to the subject matter. Five of these communicators applied to intervene in the proceedings as parties, namely:

a. All Pakistan Textile Mills Association

b. Northern Power Generation Company Limited

c. Water and Power Development Authority (Power Privatization Organization)

d. Karachi Stock Exchange (Guarantee) Limited

e. Consumer Right Commission of Pakistan

5 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 filling comments / interventions was published in newspapers

on April 30, 2003 and May 1, 2003 respectively. The public hearing commenced on May 16, 2003 and concluded on the same day. Evidence in the proceedings was also closed on the same date.

6 In the public hearing, the Petitioner presented and argued its case for an increase in the Prescribed Prices w.e.f. July 1, 2003. The interveners were provided full opportunity to assail the submissions of the Petitioner. The Case Officer of the Authority also sought various clarifications from the Petitioner in this regard. The Petitioner was also provided full opportunity to clarify and defend its Petition in respect of the points raised by the interveners as well as the Case Officer of the Authority.

7 Copies of all the evidence, exhibits and argument filed in the proceedings, together with the verbatim transcript of hearing, are available for review at the Registrar's office.

8 While the Authority has considered all the evidence and submissions presented by the parties, the Authority has decided to cite these only to the extent necessary to clarify specific issues on which it has made findings.

9 On May 21, 2003, the Authority determined the Petitioner's estimated revenue requirement for FY 2003-04 under section 8(1) of the Oil and Gas Regulatory Authority Ordinance, 2002 vide order number OGRA 6(2)-1(2)/2003. The said determination was based on the cost of gas calculated on the basis of Gas Renunciation and Reallocation Agreement between the Petitioner, Sui Southern Gas Company Limited (SSGC) and the Federal Government, through which Rs. 3,727 million was added in the estimated cost of gas purchase of the Petitioner as payable to SSGC, subject to actualization.

10 Subsequently the Federal Government has issued a Policy Guideline under section 21 of the Oil and Gas Regulatory Authority Ordinance, 2002 on June 18, 2003 as reproduced below:

> *"In order to ensure the uniform consumer gas prices all over the country, the cost of gas purchased should be worked out for both the gas companies on an overall average basis in such a manner that the input cost of gas for both the companies becomes uniform. The OGRA should work out the revenue requirement of both the gas companies on this basis with effect from financial year 2003-04. The OGRA should also develop the mechanics for inter-company adjustment of input cost of gas through a formal agreement between the two gas companies."*

11 Based on the above, the Authority changed its earlier determination on June 27, 2003.

SALIENT FEATURES OF THE PETITION

12 The Petitioner has made the following submissions in support of the Petition:

12.1 Under the provisions of the IBRD 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 requirement to cater for the cost of gas at wellhead, operating cost (T&D), depreciation and the prescribed rate of return, is to be notified as the Prescribed Price for the Petitioner, as provided in the following table:

Rupees per MMBTU

Particulars	**2002-03 Estimates**	**2003-04 Estimates**	**Increase /(Decrease)**
Cost of Gas	98.67	111.85	13.18
Operating Cost (T&D) & Depreciation	23.10	19.47	(3.63)
Return @ 17.5% of net fixed operating assets	12.84	10.67	(2.17)
Less: Operating Income	(4.44)	(3.53)	0.91
A. Total cost of supply	**130.17**	**138.46**	**8.29**
Margin available out of existing GDS to meet revenue requirement:			
Average Consumer Price	140.71	148.41	7.70
Gas Development Surcharge	10.54	12.17	1.63
B. Margin available	**130.17**	**136.24**	**6.07**
C. Shortfall in Revenue requirement (A-B)	**-**	**2.22**	**2.22**

12.2 The net operating fixed assets are projected to increase from Rs. 25,400 million to Rs. 28,852 million.

12.3 Based on the average net operating fixed assets, required return at 17.5% is computed at Rs. 4,747 million.

12.4 The net operating revenues are projected at Rs. 62,165 million, breakup of which is as follows:

Rupees in Million

Particulars	**Amounts**
Sales at current tariff	60,595

Other operating income	
Rental and Service charges	640
Surcharge and Interest on arrears	575
Amortization of deferred credit	355
	1,570
Net operating revenues	**62,165**

12.5 Unaccounted for Gas (UFG) is projected at 6.5 % (32,940 MMSCF) as against 7.02% (26,645 MMSCF) in the previous year.

12.6 Net operating expenses have been projected at Rs. 58,407 million, breakup of which is as follows:

Rupees in Million

Particulars	**Amounts**
Cost of gas sold	49,748
Operating cost (T&D)	5,270
Depreciation	3,180
Worker participation fund	169
Workers Welfare Fund	40
Net operating expenses	**58,407**

12.7 Total revenue requirement net of other operating income has been projected at Rs. 61,584 million.

12.8 Shortfall in the revenue requirement has been calculated at Rs. 989 million, which stipulates an increase of Rs. 2.22 per MMBTU in Prescribed Price w.e.f. July 1, 2003 as detailed below:

Rupees in Million

Particulars	**Amounts**
Sales at existing prescribed price	60,595
Estimated revenue requirement	61,584
Estimated shortfall in revenue requirement	989

WRITTEN SUBMISSIONS OF INTERVENERS AND RESPONSE OF THE PETITIONER THERETO

All Pakistan Textile Mills Association

13 The intervener was not present on the day during the public hearing when the case was called. The Authority, however decided to place their written submission on record for final decision. The intervener request has been fully considered.

13.1 All Pakistan Textile Mills Association (APTMA) has submitted that:

13.2 The current profitability and projected profitability of the Petitioner and its reserves are already much higher than 17.5% ROA and therefore do not warrant any further help through increase in gas tariff. In fact, based on projected profitability of the Petitioner for the year 2002 and beyond, the tariff of the Petitioner should be reduced.

Response

The increase in revenue requirement is strictly in line with the World Bank loan covenants under which the Petitioner is operating.

13.3 The Transmission and Distribution Costs (10.5% of Net Sales against international standard of 5%) of the Petitioner should be adequately controlled by giving quantified performance targets to the Petitioner's management. This measure will result in significant decrease in its operating costs and substantial improvement in profitability and cash inflow which would provide for any future operating and development funds requirement.

Response

The transmission and distribution costs of the Petitioner have in fact declined from Rs. 13.07 per MCF to Rs 11.08 per MCF.

13.4 Operating performance and cost standards based on performance and cost standards of gas companies around the world should be given as performance and cost targets to the management of the Petitioner. This professional management approach will bring about enormous improvement in operations and reduction in wastage and inefficiency.

Response

Performance standards are presently dealt with by OGRA and will be complied with after issuance.

13.5 The Petitioner will soon be privatized and as such, there is no justification or urgency for the present management for further enhancement of gas tariff which would only profit the private management at the cost of Pakistan's industry and its exports.

Response

The privatization of the Petitioner has no relevance with the current tariff petition.

13.6 In view of the impending privatization, the Petitioner should not be allowed to make any unnecessary heavy fixed investment in fixed assets which will unnecessarily increase the amount of fixed assets and the return required thereon.

Response

Assets acquisition follows a rigid sanctioning procedure and unnecessary procurements are not allowed. Acquisitions are made solely to facilitate the operations of the Petitioner.

Northern Power Generation Company Limited

14 Northern Power Generation Company Limited (NPGCL) has submitted and argued that :

14.1 Availability of sufficient gas for Northern Power Generation Company Limited's power houses from the Petitioner system has always been a problem area especially during winter period, when, due to reduced hydropower energy, reliance on thermal energy increases. Also, during such period the supply of gas is curtailed, resulting in NPGCL having to switch to costly furnace oil based generation. This results in increased prices for end consumers of electricity. In the national interest, the Petitioner may be directed to supply gas for generation purposes on priority basis. It may be noted from the table given below that gas supply to NPGCL powerhouses is reducing each year. This is a very serious situation, in the national perspective, that needs immediate intervention of OGRA as custodian of national interest in the sector.

Power Station	Gas Consumption (MMCF)		
	2000-01	2001-02	7/02/2003
Muzaffargarh	25,229.74	21,080.20	11,805.7
NGPS Multan	5,329.88	6,315.22	4,171.85
GTPS Faislabad	7,965.88	5,227.37	2,855.37
SPS Faisalabad	4,174.60	2,591.37	1,675.26
Total	**42,700.10**	**35,214.15**	**20,507.55**

Response

Petitioner has the highest regard for power generation and already provide gas to power units to its maximum ability. There have been various supply constraints which are being addressed through the Gas Infrastructure Development Project. This project costing Rs 12.00 billion envisages laying of 525 km of different dia lines and installation of additional compression capacity to make available more gas which is primarily meant for the power sector. It is hoped that on the completion of the plan in the second half of 2003-04, the situation would ease.

14.2 A good proportion of NPGCL generation is used for domestic and agricultural purpose, which is being supplied at subsidized rates. On the other hand, the price of gas for production of fertilizers (i.e. agriculture purpose) is far less than the price of gas for power generation. In the national interest, the Petitioner may be directed to provide gas for power generation at the rate they are providing gas to the fertilizer factories.

Response

The provision of gas at economical rates to NPGCL and request for subsidies allowed to the domestic and fertilizer sector are mis-directed. These matters need to be addressed by the Government of Pakistan and not the Petitioner.

14.3 During the hearings on determination of revenue requirement 2002-03 and grant of license, the MD SNGPL had agreed to provide revised gas supply agreements. NPGCL has repeatedly reminded the Petitioner to provide such agreements, but the same have not been provided. The utility may be directed to honour its commitments that were made before the honorable OGRA.

Response

The senior management of the Petitioner is actively engaged in finalizing these gas sales agreements. There is no delay on Petitioner's part. It is Petitioner's utmost endeavor that these be concluded at the earliest. In fact, this a responsibility which has been laid upon the Petitioner by the Authority. Petitioner is quite certain that the problems would be settled at the earliest. However, genuine concerns of the Petitioner need to be kept in view.

14.4 It is further mentioned here that the Petitioner's present demand for increase in gas tariff by Rs. 2.08 per MCF will put an additional burden on WAPDA due to gas consumption for power generation which will cause increased pricing for end consumers of electricity.

Response

The request for additional revenue requirements is in-line with conditionalities imposed by the World Bank. Even otherwise the major portion (about 80%) relates to the cost of gas purchased and out of the remaining costs a major proportion is more or less fixed in nature.

Water and Power Development Authority

15 Water and Power Development Authority (WAPDA) has submitted and argued that:

15.1 Gas sales are projected to increase by 34.8%, which is considered too high and may not be sustainable. It needs to be kept in view that any increase in gas price will reduce its demand. OGRA may ensure that growth projections are realistic.

Response

Misgivings have been expressed regarding the projected increase in sales by 34.8%. This is in fact mainly due to availability of gas from new fields and more sale to power, cement and normal growth in industrial commercial and domestic consumers.

15.2 Against 34.8% increase in gas sales, the cost of gas is indicated to increase by 50.5%, which is too high. The increase in sale volume should result in decrease in cost.

Response

The cost of gas is in fact a major component of over-all cost of supply of the Petitioner. It is presently in the range of 80% which is beyond the control of the Petitioner. Payments for gas purchases are decided by the Government of Pakistan, although as a matter of administrative policy these are notified by OGRA.

15.3 Transmission and Distribution costs are too high. The increase over the financial year 2002-03 is higher than the inflation rate.

Response

Transmission and Distribution costs have shown stability over time and have in fact gone down per unit as compared to FY 2002-03.

15.4 17.5% return on operating fixed assets is too high keeping in view the current economic scenario.

Response

17.5% return is required as part of the conditionalities imposed by the World Bank and Guaranteed by GOP. In fact these do not include financial charges, taxes and dividend. Once these are considered the return drops significantly. The position being that even this return is not fully capable to ensure adequate investment so as to cater to system expansion and provide gas to different parts of the country.

15.5 The Petitioner has monopolistic business with stable cash flows based on high tariff. It seems that the Petitioner's management has no pressing reason to improve performance. This situation might lead to some uneconomic investments and wasteful expenditure at the cost of the consumers. It is requested that OGRA may not allow any increase in tariff and instead direct the Petitioner to improve its efficiency and cut costs through various measures some of which are as under:

a. Organization be restructured and right-sized.

b. Staff productivity be improved through carrot and stick.

c. Procurement and contracting procedures be improved. Transparency be ensured.

d. The capital requirement be prudently assessed and managed through borrowing at the lowest market rates through competitive bidding.

e. Since the current interest rates are too low, the existing debt at higher rates be refinanced.

f. Profit/dividends be reduced.

g. The Petitioner be given target to substantially reduce its transmission and distribution losses (un-accounted for gas). Annual saving on this account be projected and accounted for in revenue.

h. Receivable be progressively decreased through an efficient recovery system. Annual recovery targets be fixed and accounted for in the revenue.

Response

a. Staff currently employed is significantly less than that required to meet even the present requirements due to system expansion.

b. Guidelines have already been introduced by the Authority.

c. Procurement and contracting procedures are transparent and are carried out at an arms length

d. Capital requirements are assessed through a rigorous procedure before consideration. Further, conditions in the market are critically examined and the Petitioner makes its best endeavors to avail funds at the lowest market rates through competitive bids.

e. Restructuring and retiring of debts carrying high rates and obtaining liquidity through lower rates is a continuous process

f. The factual position being that the Petitioner did not pay any cash dividend from FY 1992-93 to 1999-2000. Such dividends were only paid for FY 2000-2001 and FY 2001-2002 over the past ten years. Reduction or stoppage of dividend will have a serious impact on the Petitioner’s ability to attract additional funds at competitive rates.

g. UFG increase is under continuous examination at the highest level of management. The factual position being that the figures have shown a steady decline. This is due to the corrective steps taken by the Petitioner as per guidelines issued by the Authority.

h. Recovery from the debtors continues to increase through recovery enforcement program. Incidentally, if WAPDA would settle its dues, the situation can improve significantly further reducing the Petitioner’s reliance on the commercial borrowings. The Petitioner, therefore request WAPDA for an urgent settlement of our gas bills.

Karachi Stock Exchange (Guarantee) Limited

16 The intervener was not present on the day during the public hearing when the case was called. The Authority, however decided to place their written submission on record for final decision. The intervener request has been fully considered.

16.1 Karachi Stock Exchange (Guarantee) Limited (KSE) has submitted that :

16.2 The investors in the Petitioner have invested their funds on the basis of the publicly declared price formula, which assures 17.5% return on net operating fixed assets. The assured rate of return thus safeguards the investor's public interest. The average investors in the Petitioner has gone through good and bad times, where no dividends were paid for number of years.

16.3 As a custodian of the interest of the investors at large including the small investors of the Petitioner, KSE request the Authority to protect the investors' interest by maintaining the publicly declared pricing formula. The gas prices may be reviewed while ensuring protection of the shareholders. The shareholders have invested with the firm conviction that the Petitioner is entitled to a return of not less than 17.5% of the operating assets. As such any change in this agreed formula will be most inequitable and detrimental to the interest of the shareholder. This is likely to affect their confidence in the equity investments for which the present government is aggressively working and a number of fiscal measures have already been taken.

Response

The intervener has stated that the assured 17.5% return on net operating fixed assets needs to be protected so as to ensure protection to small shareholders of the Petitioner. Inability to do so will be most inequitable and have a serious detrimental impact on the capital markets. It is clarified that the 17.5% return is in fact before all financial charges, payment of income tax, dividends etc., once these are considered, the return drops drastically. Petitioner therefore feels that in order to attract capital investment and provide gas system expansion for far-flung areas, reasonable returns need to be given to shareholders. In this connection consideration be also given to include capital work in progress and working capital in the asset base. Moreover, surcharge and interest on gas sales arrears may also be treated as non-operating income. Petitioner, therefore agree with the contention of the intervener and very much hopes that the matter will be considered favorably and sympathetically by the Authority.

Consumer Rights Commission of Pakistan

17 Consumer Rights Commission of Pakistan (CRCP) has submitted and argued that :

17.1 Internal consumption of gas has increased by more than 60% (Rs. 619 million for FY 2002-03 to Rs. 1,003 million for FY 2003-04). Such a huge increase in internal consumption indicates the inefficient consumption of gas within the system of the company. The burden of this inefficiency ultimately goes to the consumer as a part of transmission and distribution cost.

17.2 The Authority should determine certain scales for internal gas consumption keeping in view the technical limitations. CRCP would also like to know from the Petitioner the reasons and justifications of such a huge increase in Internal gas consumption of the Petitioner.

Response

Increase in internal consumption is because of addition of five turbines along with increase in sales volume, i.e. upto 35% and also due to increase in gas prices from Rs 290 per HM^3 to Rs. 347 per HM^3.

17.3 Salaries, wages and benefits have increased by 36% (Rs. 2,119 million for FY 2002-03 to Rs. 2,882 million for FY 2003-04). We understand that the increase is too high with reference to the improvement in the performance of the Petitioner. Secondly, the amount under this head includes Rs. 250 million with respect to under negotiation Agreement with Collective Bargaining Agent (CBA). Such an unexamined and unjust increase has significant effect on the revenue requirement of the Petitioner.

17.4 The Authority should also rationalize the increase in the salaries, wages and benefits keeping in view the expected inflation rate and socio-economic changes. Nevertheless, salaries, wages and benefits of employees of the Petitioner should be increased but it should be linked with the improvement in their performance. Furthermore, the increase in salaries, wages and benefits should also correspond to the change in inflation rate. According to recently published “Poverty Reduction Strategy Paper” by the Ministry of Finance, the inflation rate is expected to be at about 4% in FY 2003-04. The Authority should take cognizance of this fact while determining the Prescribed Price of the Petitioner. Secondly, the Petitioner should not include amount of Rs. 250 million with regard to the under negotiation CBA Agreement until and unless the agreement is finalized.

Response

Apart from impact of CBA agreement effective 1.7.2003 i.e. Rs. 200 million and contingencies of Rs. 75 million, the increase is only about 1% over last year.

17.5 Despite explicit direction of the Authority to make concerted efforts to ensure timely recovery of receivables (Determination of Petitioner's Revenue Requirements for FY 2002-03, Page 41, Clause 17.1, e), the Petitioner has failed to reduce its outstanding receivables. The amount under this head increased from Rs. 1,121 million (FY 2002-03) to Rs. 1,170 million (FY 2003-04). This is an explicit example of inefficiency of the Petitioner to recover these outstanding receivables as well as indifferent attitude of the Petitioner towards the directions of the Authority.

17.6 The Authority should direct the Petitioner to reduce its outstanding receivables to an acceptable level. This will increase the efficiency of the Petitioner as well as help in considerably reducing the shortfall in revenue requirements.

Response

Increase in outstanding receivable is due to substantial increase in sales volume.

17.7 The Petitioner has included provision of doubtful debts in its operating cost, which has been increased by about 29% during one year (Rs. 154.95 million for FY 2002-03, as determined by the Authority on page 37 of its determination of Revenue Requirements for the Petitioner for FY 2002-03, to Rs. 200 million for FY 2003-04). The increase in these debts shows the poor management and inefficient functioning of the Petitioner and therefore, the inclusion of such debts in operating costs is totally unjust.

17.8 The Authority should exclude the provision of doubtful debts from the operating costs of the Petitioner as it is result of poor and inefficient management of the Petitioner. This will further reduce the shortfall in the revenue requirement of the Petitioner.

Response

Provision for doubtful debt is restricted to 1.5% of total outstanding receivables as per Authority's decision dated August 8, 2002.

17.9 The Petitioner has filed third consecutive petitions under the operation of the Authority for determination of revenue requirement of the Petitioner through which it has been asking for increase in its Prescribed Price to meet shortfall in its revenue requirement. (Rs. 10.55 per MCF for FY 2000-01, Rs. 5.6638 per MCF for FY 2002-03 and Rs. 2.22 per MMBTU for FY 2003-04). The Petitioner has pleaded that the increasing trend in wellhead prices and 17.5% rate of return on average net fixed assets are major reasons of this shortfall. As the third petition of the Petitioner is under consideration of the Authority since its establishment, no attention has been given towards any long-term and concrete solution to these problems and increase efficiency of the companies involved in transmission and distribution of gas. The short-term arrangement (e.g. tariff determination on annual basis) to solve the issue of shortfall in revenue requirement does not only result in wastage of time but also increases the operating costs of the Petitioner (equivalent to the petition fee and expenditures incurred on the Petitioner in form of travel and lodging expenses of the participating personnel etc.). It is suggested that instead of annual exercise, the Petitioner should come up with a long-term strategy, which should be based on extensively examined assumptions and result-oriented proposals. The Authority, on the other hand, should also determine benchmarks regarding the Operating Costs, Unaccounted For Gas (UFG) and improvement in the efficiency of the company. Such determination will build the confidence of the investor in the sector as well as help in developing trust of consumer towards the company.

Response

The request for additional revenue requirement is in-line with conditionalities imposed by the World Bank.

17.10 CRCP submits that quality of service is very important parameter, which should be kept in view while determining the revenue requirements of the Petitioner. The Petitioner does not command confidence of its subscribers at large due to its poor quality of service. In addition to frequent reports of press, CRCP have also received some complaints regarding the issues prevailing in the Petitioner's services like over billing, wrong metering, delay in issuance of new connections, low pressure of gas and load shedding during winter season, etc. CRCP requests the Authority not to allow any increase in the Prescribed Price unless the Petitioner improves its quality of service.

Response

Performance standards are presently dealt with by OGRA and will be complied with after issuance.

17.11 The data provided by the Petitioner needs to be verified very carefully because, in Annexure A of previous determination of the Authority for FY 2002-03, it appears that data calculated by the Petitioner was different to the data calculated by the OGRA. For instance, Operating Cost according to the Petitioner calculation was Rs. 4,635.000 million in FY 2002-03 while it was Rs. 4,156.950 million in FY 2002-03 according to the data calculated by the Authority. This is one single example of anomalies in the calculation of data. CRCP feels that the Authority should make some arrangements in the future for independent verification of data provided by a petitioner. This is important because even a slight variation could result in undue burden on consumers.

Response

There are no anomalies in the Petition. Example quoted by the intervener is actually the disallowance made by the Authority and not the data calculation error.

17.12 It also appears from the provision of the OGRA Ordinance and previous determinations of the Authority that the powers and functions of the Authority are limited and always subject to policy guidelines of Federal Government. For instance, Section 21 (2) (b) (Chapter III), of the Ordinance empowers the Federal Government to issue policy guidelines including but not limited to "pricing of petroleum". Section 8 says that the Authority shall determine an estimate of the total revenue requirement of each licensee for natural gas engaged in transmission, distribution and the sale of natural gas to a retail consumers for natural gas, in accordance with the rules, and on that basis advise the Federal Government the Prescribed Price of natural gas for each category of retail consumer for natural gas. Such provisions and requirements make OGRA mere an advisory body, which can recommend or advise the Federal Government with reference to issues of transmission, distribution and sale of natural gas in Pakistan. CRCP believes that only an autonomous and independent regulator can ensure the protection of interests of all stakeholders. Therefore, CRCP suggest that the regulator should be more autonomous and independent in its functioning.

Response

No comments.

COMMENTS AND OBSERVATIONS

18 Following persons made comments and observations on the Petition during the proceedings:

18.1 **Fauji Kabirwala Power Company Limited (FKPCL)**

18.2 The participant did not attend the hearing. The Authority allowed its comments to become part of the proceedings. The participant in its written submissions has shown its concerns on the following issues:

18.3 FKPCL, as consumer of Natural Gas for generation of electricity, feel that increase in gas price will adversely affect the consumer of electricity, as fuel cost is borne by WAPDA, and is ultimately paid by consumers.

GOP is encouraging to convert oil fired power plant to gas fired with a view to save foreign exchange and ensure cheaper supply of electricity to industrial and domestic consumers. By increasing the gas price we will be in-directly increasing the cost of electricity which adversely affect competitions amongst IPPs.

The increase in gas price is, therefore, not supported.

Response

The Petitioner appreciate the concerns expressed by FKPCL that any increase in tariff would be considered as an additional cost by WAPDA and be subsequently passed on to consumers. However, be that as it may, the request for additional revenue requirements is based on the conditionalities imposed by the World Bank and guaranteed by the GOP. Even otherwise, 80% of the cost relates to the cost of gas which is beyond control of the Petitioner. It is Petitioner's request that the comments be considered in the light of World Bank conditionalities

18.4 **Kot Addu Power Company (KAPCO)**

18.5 The participant did not attend the hearing. The Authority allowed its comments to become part of the proceedings. The participant in its written submissions has shown its concerns on the following issues:

18.6 KAPCO being the largest 1600 MW thermal power plant of Pakistan is consuming about 32,000 MMCF gas yearly which is about 10% of the total sales volume of the Petitioner. If the Petitioner's request for increase in the tariff is honoured by the OGRA then KAPCO gas fuel cost will increase about 60 to 70 million rupees per year. KAPCO will pass on 90% of this additional cost to WAPDA by increasing its electricity tariff.

KAPCO has very clear views that any increase in the gas tariff will affect the KAPCO business as below:

- WAPDA power consumers tariff will increase
- WAPDA payments to KAPCO will become slow
- KAPCO cash flow will be disturbed
- KAPCO operating cost will increase
- KAPCO plant merit order comparatively to oil fired IPPs will be descended.

Response

The comments filed by KAPCO are similar to that of FKPCL and as such Petitioner's reply is same as that discussed in para 18.3 above.

18.7 **Arif Habib Investment Management Limited**

18.8 The participant did not attend the hearing. The Authority allowed its comments to become part of the proceedings. The participant in its written submissions has shown its concerns on the following issues:

18.9 The investors in Mutual Funds include small investors and retirement funds. They have invested in the Petitioner on the basis of the publicly declared price formula, which assures 17.5% return on net operating fixed assets. The assured return thus safeguards the investing public's interest. Please note that the average investors in the Petitioner has to take the good and bad; there have been many lean years for the Petitioner when it could not pay out dividends. Arif Habib as a stakeholder and manager of the Funds and on behalf of the small investors in Arif Habib's Funds requests OGRA to protect the investors' interest by maintaining the publicly declared pricing formula.

Response

The comments filed by Arif Habib are similar to that of KSE and as such Petitioner's reply is same as that discussed in para 16.3 above.

18.10 **General Public**

18.11 On behalf of the general public M/s Qazi Muhammad Ilyas and Agha Mujeeb of Agha Mujeeb and Company Chartered Accountants submitted comments and asked the Authority to take them into consideration while finalizing the determination of estimated revenue requirements.

18.12 Qazi Muhmmad Ilyas has submitted that:

18.13 Increase in gas prices will directly burden the common people and national industry. Rates of many things like bread, bakery items etc will be increased and the purchasing power of the common people will be disturbed. It is suggested that UFG and un-necessary expenses be controlled instead of increasing the gas price.

18.14 Observations made by Agha Mujeeb are as follows:

18.15 It is observed that the Petitioner is purchasing gas from various fields at different prices. The Petitioner should try to purchase maximum gas from a field, which offers minimum price, and avoid purchasing gas from fields that offers high prices. It is their understanding that the cost of gas production from all fields is usually the same; it may be so that there be a difference in the transportation and distribution cost. It is suggested that OGRA should enquire about the maximum gas production per day of various fields and advise the Petitioner to purchase maximum gas from a field offering low price. This would automatically reduce the cost of gas, which ultimately reduces, the requirement for increase in tariff for the year 2003-04.

18.16 In the schedule of operating cost, it was observed that no corresponding figures for the previous years were provided in order to draw any analysis or to make any comparisons.

18.17 It was observed that the cost of stores and spares written off amounts to Rs. 8 million. It is suggested that the nature of items written off should be analyzed and if possible should be auctioned in order to reduce expense/cost. It was also observed that stores and spares management policy has not been stated. Moreover, the circumstances under which, the Stores and Spares were being written off.

18.18 The Petitioner has provided for a provision for doubtful debts at Rs. 200 million, which is 1.4% of book debts. The Petitioner has not provided the policy and nature of this provision.

18.19 Rs. 59 million and Rs. 152 million expenses are projected by the Petitioner for traveling and transport expenses respectively under operating cost. OGRA should enquire the purpose of these expenses as to why they are under distinctive heads. Moreover, transport expense of Rs. 152 million seems to be very high.

18.20 Other expenses of Rs. 100 million also seem to be unjustified for the year under petition.

18.21 Gas internally consumed projected by the Petitioner at Rs. 1,003 million does not seem to qualify as an operating expense. During the review of petition of SSGCL, it was observed that gas consumed internally by the Petitioner was of Rs. 259 million for the projected year 2003-04. whereas gas internally consumed by the Petitioner for the year under petition is Rs. 1,003 million, which shows a high consumption of Rs. 744 million by the Petitioner.

18.22 It was observed that the addition of fixed assets of Rs. 6,053 million was shown for the year 2002-03, which resulted in increase of depreciation by Rs. 424.03 million for the same period. In FY 2003-04 the Petitioner is again projecting an addition of Rs, 6,727 million in fixed assets. This will result in additional depreciation of Rs 233.275 million over financial year 2002-03, which ultimately results in a decrease in the net profit for the year 2003-04 and therefore, adversely affects the revenue requirement for the year 2003-04. It is suggested that a detailed study of the addition in fixed assets may please be made and an independent report of some technically qualified person should be demanded from the Petitioner, who should assess the technical feasibility of the addition in fixed assets for the year 2003-04.

18.23 The figure of book debts has risen by Rs. 4,098 million for the year 2003-04, which is almost 40% increase over 2002-03, This increase in book debts may be partly due to increase in the number of customers for the year under petition and partly due to loose internal controls over debtors. By maintaining efficient control over book debts, the position of revenue collection may actually improve.

18.24 The current liability under gas and purification charges for the year 2003-04 is Rs. 8,291 million, which is an increase of 50.53% from last year. The liability for gas and purification charges for the year 2001-02 was Rs. 5,074 million and it was Rs. 5,508 million in 2002,03, which is only an increase of 8.55% over 2001-02. This would impact the future cash flows of the Petitioner.

18.25 The redeemable capital under current liabilities is Rs. 1,787 million for the year under petition, whereas it was only Rs. 416 million in 2002-03, which is an increase of 330%.

18.26 The overall operating cost of the Petitioner for the year under review is Rs. 5,270 million, whereas the operational cost for SSGCL for the year under review is Rs. 3,969.702 million. This means the operating cost of the Petitioner is higher by Rs. 1,300.30 million (32.76%), which clearly suggest that the Petitioner should control its overhead expenses.

18.27 It is suggested that a slight increase in tariff may not have a significant impact on the Petitioner, but it would drastically affect the country's economy thereby increasing the cost of production of almost all industries and thus reducing exports. On the other side, due to the rise in prices of industrial products, consumers will not be able to afford high priced goods, which will ultimately result in the decrease in industrial output and hence increase the unemployment rate.

Response

In the public hearing the Petitioner responded that most of the observations have already been addressed earlier and also explained the salient features of its projected financial statements to the satisfaction of the participants.

DETERMINATION OF THE AUTHORITY

19 The Authority, after taking into consideration the points raised by the interveners and participants, the clarifications provided by the Petitioner and scrutiny of the Petition, has considered the following points:

19.1 The wellhead prices of gas are determined on basis of contracts and agreements signed by the gas producers with the Federal Government and the revenue requirements of the Petitioner are determined after accounting for the cost of gas which constitutes about 80% of the revenue requirement.

19.2 The Authority also sets appropriate benchmarks and keeps under review the element of unaccounted for gas (UFG) so that their inefficiencies are not passed on to the consumers. The Authority carries out detailed scrutiny of the operating cost and puts in place an effective monitoring mechanism to ensure that the consumers are not burdened on account of imprudent expenditure.

19.3 The Federal Government is empowered to issue the policy guidelines not inconsistent with the OGRA Ordinance and the Authority is obligated under the law to implement the same.

19.4 The role of Authority is to be seen in light of the powers granted under the law, which requires the Authority to safeguard the interest of all the stakeholder.

19.5 In view of the above, the observations of some of the interveners on the role of the Authority are not valid.

RATE OF RETURN

20 The Petitioner is calculating its revenue requirement on the basis of 17.5% return on average net fixed operating assets in accordance with covenants agreed with the International Bank for Reconstruction and Development (IBRD).

20.1 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.

20.2 The Authority is therefore obligated to discharge the statutory duty of determining a reasonable rate of return in consultation with Federal Government & Licensees.

20.3 Process for determining reasonable rate of return is already underway. A Study funded by Public Private Infrastructure Advisory Facility (PPIAF) is being carried out by Economic Consulting Associates (ECA), selected by World Bank after competitive process, pertaining to development of tariff Regulatory Regime for regulated natural gas sector in Pakistan. TOR's for the Study were developed in consultation with the Federal Government & licensees. The study is expected to be completed by October 2003. The Authority, based on recommendations / findings of the study, will hold consultation sessions with Federal Government & Licensees, in order to determine a reasonable rate of return.

20.4 In the meantime, the Federal Government has issued an order under section 47 of Oil and Gas Regulatory Authority, Ordinance, 2002, that till such time an appropriate rate of return is determined by the OGRA, in consultation with the Federal Government and the licensees, it shall determine the revenue requirement of the existing gas companies on the basis of the covenants stipulated in the loan agreements of the Petitioner with the

IBRD.

OPERATING FIXED ASSETS

21 The Petitioner has projected the net operating fixed assets at Rs. 28,852 million in the financial year 2003-04 as follows:

Rupees in million

Particulars	FY 2003-04	FY 2002-03
Fixed assets at cost	60,052	53,325
Less: Accumulated depreciation	27,438	24,258
	32,614	29,067
Less: Deferred credit for completed jobs		
Total as per balance sheet	3,962	3,967
Less: Work in progress	200	300
	3,762	3,667
Net fixed assets in operation	**28,852**	**25,400**

21.1 The Petitioner has projected an addition of Rs. 6,727 million in the fixed assets, which is as follows:

Rupees in million

Particulars	*Amount*
Fixed operating assets at cost as at July 1, 2003	53,325
Additions:	
Gas infrastructure development project	3,877
Distribution development	2,300
Spurs to new towns	200
Plant & machinery, transport, furniture etc	350
	6,727
Fixed operating assets at cost projected at June 30, 2004	60,052

21.2 The Petitioner is projecting an addition of Rs. 3,877 million in Transmission System under Gas Infrastructure Development Project detail of which is as under:

Particulars	**Length** ***Miles***	**Diameter** ***Inches***	**Amount** ***Rupees in millions***
Sawan-Qadirpur Pipeline	81.27	24	1,202
Gujranwala – Gujrat Pipeline	12.26	18	107
Sawn River Crossing	0.30	36	71
Pipeline up stream of Compressor Station AC7 (Shorkot)	20.50	36	623
	114.33		**2,003**
Coating Plant and rebuilding of existing equipment			168
Compression			1,310
SCADA(T)			21

Construction Equipment Borrowing Cost			211 164
Projected Commissioning of Transmission Network			**3,877**

21.3 In compliance with the directives of the Government of Pakistan received by the Petitioner vide letter No. NG(I)-16(I)/GM/2000 dated July 7, 2000, the Petitioner has planned to displace furnace oil through supplying of 525 MMSCFD gas from Sui & newly discovered fields in the South to power stations namely KAPCO, WAPDA (Muzafargarh), WAPDA (Multan) and ROUCH, Abdul Hakim.

21.4 It was stated that at present the requirement of the above mentioned power plants is being met through imported furnace oil containing significant amount of sulphur. This is causing a heavy burden on country's foreign exchange resources apart from polluting the environment.

21.5 Combustion of natural gas particularly in gas turbines at KAPCO and ROUCH power plants, presently using low sulphur and high sulphur furnace oil respectively, would increase power generation efficiency of these plants beside reducing their operating and maintenance cost. After completion of the project, supply of 525 MMSCFD of indigenous natural gas would enable displacement of about 4.47 million tons of imported furnace oil per year effecting yearly saving of about US$500 million.

21.6 The Gas Infrastructure Development Project envisages expansion of the Petitioner's transmission system between Sui and Multan by laying 353 miles of transmission lines, installation of SCADA system and installing additional 25,000 HP of compression units. The project is estimated to cost Rs. 12.5 billion with foreign exchange component of Rs. 3.4 billion for which the Petitioner has firmed up financing per project implementation schedule. The system capacity of the Petitioner would increase from 980 MMSCFD to 1,380 MMSCFD after completion of the project. The project was approved in principle by the Cabinet on August 9, 2000. The work on this project commenced in May 2001 and is expected to be completed in February 2004.

21.7 Petitioner claimed addition of Rs. 2,300 million in distribution development. The Petitioner has planned to lay 1,200 Km of distribution mains of different diameters, 150 new industrial connections, 2,800 new commercial connections and 110,000 new domestic connections.

21.8 In addition to these, the Petitioner has also projected to construct Sale Meter Stations (SMS), Town Border Stations (TBS), District Regulating Stations (DRS) and replacement of under sized meters amounting to Rs. 425 million. Detail of distribution development is as under:

Rupees in million

Description	Physical Targets	Amount
Distribution mains ranging from 1 inch dia to 16 inches dia pipeline	1,200 KM	1,174
New Connections		
Industrial	150 Nos.	57
Commercial	2,800 Nos.	45
Domestic	110,000 Nos.	704
Construction of SMSs, TBSs, DRSs and replacement of under sized meters		425
Capital expenditures during financial year 2003-04		2,405
Add: Work in progress as on July 1, 2003		440
		2,845
Less: Estimated work in progress as on June 30, 2004		(540)
Projected Commissioning of Distribution Network		2,305
	Say	**2,300**

21.9 Petitioner claimed an amount of Rs. 200 million on account of laying of 50 KM 8 inch spur to new towns.

21.10 The Petitioner has projected an increase of Rs. 350 million in Plant & Machinery and Equipment etc. Out of the total increase, Rs. 255 million pertains to new additions and Rs. 95 million relates to replacement of old plant and machinery etc.

Description	Addition	Replacement	Total
Plant & Machinery			
Welding plants, beveling machines, trailers, tractors, pipe locators, gen sets, radiators, dope kettles, holiday detectors, flow records, grinding machines, power brushes, leak detectors, dead weight testers etc.	40	25	65
Construction of sale meter stations / modification	25		25
Cathodic Protection System	20		20
Installation of 20" dia flow controllers and 24" dia run at down stream of purification plant at Sui	20		20
Civil construction			
Construction of distribution office Peshawar	96		96
Construction of workshops, chowkidar huts, power houses, approach roads, quarters, condensate gathering tank, repeater station at Thandiani and store shed etc.	20		20

Transport vehicles	10	70	80
Miscellaneous Furniture, office equipment, computers, telecom equipment, electrical appliances, gas appliances, air conditioners, refrigerators and misc. loose tools.	24		24
	255	***95***	***350***

21.11 On scrutiny of the cost estimates, it transpired that cost contingencies have been built into the projected additions and also that actualization is generally lower than the estimates. The Authority therefore decides to make ad-hoc deduction @ 20% in the cost of assets likely to be commissioned by June 30, 2004. **Consequently the net addition in the fixed assets for the FY 2003-04 is provisionally allowed at Rs. 5,382 million, subject to actualization, as against the claim of the Petitioner amounting to Rs.6,727 million.**

21.12 **Depreciation has also been reduced due to savings on account of contingencies, as explained above, amounting to Rs. 47 million.**

OPERATING INCOME

22 Sales volume

22.1 Sales volume has been projected to increase by 35% from 352,590 MMSCF for the financial year 2002-03 to 475,434 MMSCF for the financial 2003-04.

22.2 The category wise comparison of sales volume from last year is provided below:

Volume in MMSCF

CATEGORY	FY 2003-04	FY 2002-03	%Increase
Power	207,522	99,280	109%
Cement	10,248	6,935	48%
Fertilizer	47,214	46,355	2%
General industries	88,206	85,775	3%
Commercial	17,202	16,425	5%
Domestic	105,042	97,820	7%
TOTAL	**475,434**	**352,590**	**35%**

22.3 The main reason for increase in the sales volume is on account of higher sales projection to power, and cement sectors and normal growth in industrial, cement, commercial and domestic consumers. This higher projection in power sector is due to the expected completion of Gas Infrastructure Development Plan in February 2004, after which the Petitioner will be able to carry additional 525 MMSCFD gas from newly discovered southern fields to its power sector consumers likes KAPCO, ROUCH etc.

22.4 Since 1989-90, gas sales by the Petitioner have cumulatively increased by 101%. This is evident from graph below:

22.5 **The Petitioner projected excessive targets for Gas Internally Consumed for FY 2003-04, which have been reduced by the Authority, as explained in para 29 below. The consequential impact has been taken in projected sales volume, which have been increased by 1,860 MMSCF(1,740 MMBTU).**

22.6 **Sales Revenue**

22.7 Gross sales revenue for the financial year 2003-04 has been projected by the Petitioner at Rs. 66,010 million as against Rs. 47,131 million for the financial year 2002-03, which shows an increase of 40% over the last year.

22.8 This increase is due to more projected sales to power sector, which has higher sale prices. This is evident from the table below:

	2003-04				***2002-03***			
Category	**Sales Volume** ***MMSCF***		**Sales Revenue** ***Rupees in million***		**Sales Volume** ***MMSCF***		**Sales Revenue** ***Rupees in million***	
Power	207,522	44%	33,060	50%	99,280	28%	15,899	34%
Fertilizer	47,214	10%	3,765	6%	46,355	13%	3,728	8%
Industries	98,454	21%	16,067	24%	92,710	26%	15,074	32%
Commercial	17,202	5%	3,058	5%	16,425	5%	2,951	6%
Domestic	105,042	22%	10,060	15%	97,820	28%	9,479	20%
	475,434	**100%**	**66,010**	**100%**	**352,590**	**100%**	**47,131**	**100%**

22.9 Sales at current tariff i.e. net of gas development surcharge, is projected to increase by 48% from Rs. 40,990 million in financial year 2002-03 to Rs. 60,595 million in financial year 2003-04.

22.10 **As explained in para 22.5 above, the sale revenue at current tariff has increased by Rs.269.851 million due to adjustment in gas sales volume.**

22.11 **Rental and Service Charges**

22.12 The Petitioner has projected the revenue on account of rental and service charges to increase by 4.92% from Rs. 610 million (financial year 2002-03) to Rs. 640. million (financial year 2003-04) as compared below:

Rupees in million

FY 2003-04	FY 2002-03	FY 2001-02	FY 2000-01
640.000	610.000	585.019	589.680

22.13 This projected increase is due to 112,950 new connections, the Petitioner is planning to provide under distribution development program, as evident in para 18.7 above.

22.14 For each additional Industrial, Commercial and Domestic connection the Petitioner is earning Rs. 250 per month (i.e. Rs.3,000 per annum), Rs. 100 per month (i.e. Rs. 1,200 per annum) and Rs. 20 per month (i.e. Rs. 240 per annum) respectively on account of meter rentals. Therefore, in addition to last year's rental and service charges of Rs. 610 million, the Petitioner will be earning additional Rs. 30 million on account of new connections.

22.15 **The Authority provisionally accepts projected revenue from rental and service charges at Rs. 640 million for the financial year 2003-04 which will be subject to actualization.**

22.16 **Surcharge and interest on arrears of gas sales**

22.17 The Petitioner has projected surcharge and interest on arrears of gas sales to increase by 10.4% i.e. from Rs. 525 million (financial year 2002-03) to Rs. 575 million (financial year 2003-04) as compared below:

Rupees in million

FY 2003-04	FY 2002-03	FY 2001-02	FY 2000-01
575.000	525.000	475.570	110.493

22.18 Category wise detail of late payment surcharge for last year and projection for current year with 10% escalation factor submitted by the Petitioner is as follows:

Rupees in million

Actual for 2001-02	Industrial	Commercial	Bulk Domestic	Domestic	Total
Interest	98.744	44.609	154.397	-	297.750
Surcharge				225.377	225.377

	98.744	44.609	154.397	225.377	523.127
Escalation by 10%	9.874	4.461	15.440	22.538	52.313
	108.618	49.070	169.837	247.915	575.440

Say Rupees 575 million

22.19 It is further noted that interest income on WAPDA gas bill arrears has not been recognized in the Petition for the financial year 2003-04. The Authority maintains its earlier directions given vide para 8.17 of its decision dated October 24, 2002 and para 12.19 of its decision dated March 12, 2003**. With these directions the Authority provisionally accepts the surcharge and interest on arrears of gas sales at Rs. 575 million, subject to actualization.**

23 **Amortization of deferred credit**

23.1 The Petitioner has projected deferred credit amortization for the financial year 2003-04 at Rs. 355 Million as follows:

Rupees in million

FY 2003-04	FY 2002-03	FY 2001-02	FY 2000-01
355	334	320	278

Rupees in million

Description	FY 2003-04	FY 2002-03
Balance as at July 01	3,967	3,981
Receipts during the year	350	320
	4,317	4,301
Amortization for the year	(355)	(334)
Unamortized balance as at June 30	3,962	3,967

23.2 Deferred credit comprises the recoveries from customers on supply of gas and government grants. These are amortized at the rate of 6% per year and credited to the income of the Petitioner for that year. However, for the first year recoveries are amortized at 3%.

23.3 **The Authority provisionally accepts amortization of deferred credit projected at Rs. 355 million for the financial year 2003-04 which will be subject to actualization.**

OPERATING EXPENDITURES

24 **Cost of gas**

24.1 The Petitioner has projected the cost of gas sold to increase by 50.53% in absolute terms from Rs. 33,049 Million (financial year 2002-03) to Rs. 49,748 million (financial year 2003-04) as follows:

24.2 The main reason for increase in cost of gas is the projected injection of newly discovered gases from southern resources, namely Zamzama and Sawan. Furthermore additional gas is also expected from Sui, Qadirpur and Kandkot fields. In addition to the

34% overall volumetric increase in purchases, the average rate of wellhead gas has also increased by 13.19%, which is owed to the annual increase in cost of gas from Sui after the dismantling of Sui Gas Purchase Agreement and higher costs of Zamzama and Sawan fields.

24.3 In its earlier decision dated May 21, 2003, Authority increased the Petitioner's cost of gas by Rs. 3,727 million as a differential of wellhead cost between Bhit gas and Sui & Pirkoh gas. This was done in accordance with the Gas Renunciation and Reallocation Agreement (the Agreement) signed between the Petitioner, Sui Southern Gas Company Limited (SSGCL) and the Federal Government on 25th November, 2000, whereby the SSGCL has renunciated its right from the allocated quantities of gas from Sui and Pirkoh in lieu of additional quantities becoming available from the newly discovered gas fields in the south including Bhit.

24.4 As per the Federal Government Policy Guideline dated June 18, 2003, the cost of gas purchased should be worked out for both the gas companies on an overall average basis in such a manner that the input cost of gas for both the companies becomes uniform.

24.5 Based on the above guideline, the input cost of gas purchase is computed at Rs. 116.15 per MMBTU for Sui Southern Gas Company Limited and Sui Northern Gas Pipelines Limited, therefore increasing cost of gas of the Petitioner by Rs. 6,123.829 million as against Rs. 3,727 million as per short order dated May 21, 2003, as tabulated below:

24.6 Since the input cost of gas has been recomputed in accordance with the above mentioned Policy Guideline and disallowance has been made in the volume of gas projected for gas internally consumed, the consequential adjustment in gas internally consumed has also been made, as discussed in para 29 below.

24.7 **The estimated cost of gas sold now amounts to Rs. 55,955 million as against Rs. 53,657 million as per determination dated May 21, 2003, subject to actualization.**

25 **Operating (Transmission and Distribution) cost**

25.1 The Petitioner has projected transmission and distribution cost to increase from Rs.

3,988 million (FY 2002-03) to Rs. 4,267 million (FY 2003-04) which represents an increase of 7.0% over the previous financial year as compared below:

Rupees in million

Particulars	**2003-04** **Estimates**	**2002-03** **Estimates**	**Increase / (Decrease)**	**%**
Salaries and wages	2,882	2,279	603	26%
Medical and welfare	486	442	44	10%
Stores and spares	201	183	18	10%
Fuel and power	130	118	12	10%
Repair and maintenance	360	354	6	2%
Rent, rate, telephone and Electricity	70	64	6	9%
Insurance	129	117	12	10%
Traveling	59	54	5	9%
Stationery, telegram and postage	40	36	4	11%
Dispatch of gas bills	39	35	4	11%
Transport expenses	152	138	14	10%
Professional services	20	19	1	5%
Gathering charges of billing data	36	34	2	6%
Stores and spare written off	8	-	8	100%
Provision for doubtful debts	200	155	46	29%
Gas bills collection charges	41	39	2	5%
Other expenses	100	94	6	31%
	4,953	4,161	793	19%
Less: Allocated to fixed capital expenditures	743	673	70	10%
Add: Annual license fee	57	50	7	14%
Add: Contingency reserve	-	450	(450)	(100%)
Total	4,267	3,988	280	7%

25.2 Various components of operating cost are discussed in the following paragraphs.

25.3 **Salaries and wages**

25.4 The Petitioner has projected salaries and wages for financial year 2003-04 at Rs 2,882 million, which is an increase of 26% from last year.

25.5 Details of salaries and wages expenses are as follows:

Rupees in million

Particulars	**2003-04** **Estimates**	**2002-03** **Estimates**	**Increase / (Decrease)**	**%**
Salaries	450	435	15	3%
Wages	1,241	1,245	(4)	0%
10 C Bonus	100	100	-	0%
Agreement bonus	124	125	(1)	-1%
Overtime	133	136	(3)	-2%
Casual labour	43	40	3	9%
	55	51	4	8%

Gratuity				
Pension	122	111	11	10%
EOBI	19	16	3	18%
LFA	41	41	(0)	-1%
Housing and accommodation	2	2	(0)	-4%
Insurance	26	24	2	6%
Estimated impact of CBA Agreement w.e.f. 1.7.2001	150	150	-	0%
Estimated impact of CBA Agreement w.e.f. 1.7.2003	200		200	100%
Others	2	1	1	100%
Contingencies	75		75	100%
	2,782	2,477	305	12%
Incremental impact of IAS 19	100	77	23	30%
Total	2,882	2,554	328	13%
Disallowance	-	275	(275)	-100%
Grand Total	2,882	2,279	603	26%

25.6 The Petitioner is not projecting any increase in number of executives during FY 2003-04. However, it is projecting 3% increase in their salaries, keeping in view the normal increments given to its executive staff.

25.7 In subordinate staff, the Petitioner is projecting 3% decrease in their total strength. Increments given to the subordinate staff are off set by the decrease in subordinate staff numbers, therefore, in monetary terms the increase in sub-ordinate staff cost is projected at zero percent.

25.8 The Petitioner has claimed Rs. 124 million as agreement bonus, Rs. 350 million on account of CBA agreements and Rs. 75 million on account of contingences, which have not yet been concluded. The Authority in its determination dated August 8, 2002, October 24, 2002 and March 12, 2003 disallowed the provision on account of CBA agreements with a direction that any amount due on this account shall be adjusted in the revenue requirement for the financial year in which the agreement has been actually concluded in line with the guiding principles laid down by the Authority.

25.9 Other costs have either remained constant or have increased due to consequential impact of increment given to the employees or increase in terminal benefits based on number of years served with the Petitioner.

25.10 **In view of the above, the Authority disallows provision of Rs. 549 million for CBA agreements, agreement bonus and contingences, with a direction that whole issue of CBA agreement including bonus to unionized staff is revisited in accordance with the relevant labour & corporate laws and the guiding principles enunciated earlier by the Authority.**

25.11 **Medical and welfare**

25.12 The Petitioner has projected medical and welfare for financial year 2003-04 at Rs. 486 million, which is an increase of 10% from last year.

25.13 Details of medical and welfare expenses are as follows:

Rupees in million

Particulars	2003-04	2002-03	Increase / (Decrease)	%
Executives	27	25	2	8%
Subordinates	141	130	11	8%
Annual sports and staff welfare	20	18	2	11%
	188	173	15	9%
Incremental impact of IAS 19	298	270	28	10%
Total	486	443	43	10%

25.14 As per the Petitioner, the increase in medical expenses is mainly due to the increase in ages of employees, cost of medicines, hospitalization and operations cost and provision under IAS-19.

25.15 **Based on the current inflationary trend, 11% increase in the medical & welfare expense (excluding IAS 19 impact) from last year seems to be on the higher side and is not reasonable, therefore it is decided that except for the provision under IAS 19, which the Authority accepts at Rs. 298 million, rest of the projected expense will only be allowed at 5% above last year's amount of Rs 173 million. An amount of Rs. 6.534 million is disallowed from the medical and welfare expense, subject to actualization.**

25.16 **Repair and Maintenance expense**

25.17 The Petitioner has projected repair and maintenance to increase from Rs. 354 million to Rs. 360 million as compared below:

Rupees in million

FY 2003-04	FY 2002-03	FY 2001-02	FY 2000-01
360	354	180	188

The breakup of repair and maintenance is given below:

Rupees in million

Particulars	FY 2003-04	FY 2002-03
Transmission	211.131	135.525
Distribution	89.082	164.678

Compression	11.185	9.474
Others	48.927	44.160
Total	360.325	353.837

25.18 The Petitioner has projected to recoat the following transmission lines as per Security of Transmission Pipelines program:

i. 24” dia 7 miles long line at AC -4(Uch) station

ii. 18” dia 3 miles long line at AC-7 (Shorkot)

iii. 18” dia 5 miles long line from AC-1(Guddu) to AC-1X (Bhong)

iv. 18” dia 7 miles long line from A-6 (Shujabad) to AV-22 (Valve assembly between Multan and Shujabad)

v. 10” dia 10 miles long Gali Rinyal Line

vi. 8” dia 19.25 miles Dhullian / Daudkhel line

25.19 The Petitioner has also projected online pigging operations in the following sections:

i. 18” AC-1(Guddu) – AC-1X (Bhong)

ii. 30” AC-1(Guddu) – AC-1X (Bhong)

iii. 30” AC-1X (Bhong) – AC-4 (Uch)

iv. 18” AC-1X (Bhong) – AC-4 (Uch)

v. 30” AC-4(Uch) - AV-15 (upstream valve assembly at Sutlej crossing)

vi. 24” AC-4 (Uch) - AV-15 (upstream valve assembly at Sutlej crossing)

vii. 18” AC-4 (Uch) - AV-15 (upstream valve assembly at Sutlej crossing)

viii. 30” AV-20 (downstream valve assembly at Sutlej crossing)– AC-6 (Multan)

ix. 24” AV-20 (downstream valve assembly at Sutlej crossing) – AC-6 (Multan)

25.20 The Petitioner has also projected to achieve following targets in distribution and compression during FY 2003-04:

Distribution department repair and maintenance targets

Description		2003-04	2002-03
Line patrolling of distribution system	KM	36,943	35,293
TBS	No.	1,260	1,180
DRS	No.	525	425
Commercial CMS	No.	42,922	40,122
Industrial CMS	No.	2,878	2,678
Valve Maintenance	No.	10,200	9,600
Underground leakage rectification	No.	3,800	3,600
Domestic consumers	No.	2,283,677	2,173,677
Coat and Wrap repairs	KM	250	225
Number of CP Stations	No.	809	749
Uplifting of service lines	No.	18,600	17,700
Shifting of service lines	No.	4,750	4,500
Defective domestic meter replacement	No.	125,000	125,000

Compression department's repair and maintenance targets

	2003-04	2002-03
Overhauling of compression engine		
Saturn engines	7	6
Centaur engines	3	2
Maintenance		
Saturn Package	32	32
Centaur Package	34	29

25.21 **Since the Petitioner is making efforts to reduce UFG the Authority provisionally accepts repair and maintenance expense projected at Rs. 360 million for the financial year 2003-04 which will be subject to actualization.**

25.22 **Provision for stores and spare written off**

25.23 The Petitioner has projected a provision for stores and spare written off at Rs. 8 million.

25.24 It is noted that any write offs in the stores and spares is not justified, as it was Petitioner's imprudent inventory management that created obsolete stock. Any impact of obsolete stocks should be borne by the Petitioner rather than passed on to the consumers.

25.25 **Based on the above, the Authority disallows the write off in stores and spare amounting to Rs. 8 million.**

25.26 **Provision for doubtful debt**

25.27 The Petitioner has projected provision for doubtful debt to increase from Rs. 155 million (FY 2002-03) to Rs. 200 million (FY 2003-04) as compared below:

Rupees in million

FY 2003-04	FY 2002-03	FY 2001-02	FY 2000-01
200	155	140	255

25.28 **The Authority provisionally allows Rs. 200 million as provision for doubtful debt which will be subject to actualization in accordance with the policy approved by the competent forum.**

26 **Other Expenses**

26.1 The items of transmission and distribution costs, excluding items discussed in para 25.1 through 25.28 have been allowed by the Authority after giving 5% increase over and above the amounts allowed by in its determination dated March 12, 2003 for FY 2002-03. However gas internally consumed, has not been treated as part of T&D expenditure. Also, no disallowance was made in the professional services, expense relating to gathering charges of gas bills collection data and gas bills collection charges, since it falls within the 5% increase limit over & above the FY 2002-03 determined expenses.

27 **Deferral Account**

27.1 The determination is made on a provisional basis for which the Petitioner has submitted estimated revenues and expenditure. Since the ascertainment of the actual cost at this stage is difficult, the Authority has provisionally established a deferral account to capture various elements of cost which would become firm at the close of year.

27.2 This mechanism also enables correct reflection of cost to the present consumer for the services received in the current financial year as otherwise the future consumer would be additionally burdened with the cost chargeable to current consumers. Thus, correct pricing signals can be given through this mechanism.

27.3 This deferral account is an adjusting account which shall be squared off at the time of final determination under section 8(2) of the Oil and Gas Regulatory Authority Ordinance, 2002.

27.4 In para 25.8 above the Authority has disallowed an amount of Rs. 549 million on account of provision for CBA agreement, agreement bonus and contingencies pending actual signing of the agreement. **In order to capture the unascertained expenditure including the above items in accordance with the World Bank loan covenants, the Authority allows establishment of a deferral account amounting to Rs. 494.100 million in the estimated revenue requirement of the Petitioner for the financial year 2003-04.**

28 **In view of the above, the Authority provisionally determines operating cost at Rs. 4,159 million as against Rs. 4,267 million claimed by the Petitioner, subject to directions given in para 25.1 through 27.4 supra**.

Detail of operating expenditure

Rupees in million

	Operating expense	
	Claimed by the Petitioner	**Allowed by OGRA**
Salaries and wages	2,882	2,333
Medical and Welfare	486	479
Stores and Spares consumed	201	192
Fuel and Power	130	124
Repair and Maintenance	360	360
Rent, Rate, electricity and Telephone	70	67
Insurance	129	123
Traveling	59	57
Stationery, telegram and postage	40	38
Dispatch of gas bills	39	37
Transport expenses	152	145
Professional services	20	20
Gathering charges of gas bills collection data	36	36
Stores and spares written off	8	-
Provision for doubtful debts	200	200
Gas bills collection charges	41	41
Other expenses	100	99
	4,953	4,350
Less: Allocated to fixed capital expenditures	743	743
	4,210	3,607
Add: OGRA fees	57	57
	4,267	3,664

Add: Deferral account	-	494
	4,267	4,159

GAS INTERNALLY CONSUMED

29 The Petitioner has projected gas internally consumed to increase from Rs. 619 million (FY 2002-03) to Rs. 1,003 million (FY 2003-04) as compared below:

Rupees in million

Particulars	**FY 2003-04**	**FY 2002-03**	**FY 2001-02**
Transmission	17.421	13.797	10.952
Compression	910.009	541.910	517.019
Free gas facility	67.730	56.931	52.748
Others	7.641	6.176	6.260
Total	1,002.801	618.814	586.979

29.1 Detailed analysis of gas used in compression is as follows:

Particulars	**FY 2003-04**	**FY 2002-03**	**FY 2001-02**
Compressor running hours	655,000	450,000	433,845
Volume of gas used in compression (MMSCF)	9,299	6,393	6,372
Volume transmitted (MMSCF)	520,518	388,431	358,939
% of gas used in compression with total gas transmitted	1.79%	1.65%	1.78%

29.2 **The above analysis indicates that the projections for FY 2003-04 are not realistic and appear to be on the higher side. In view of the foregoing, the Authority made reduction in the gas used for compression by 20% i.e. allowed it at 7,439 MMSCF as against 9,299 MMSCF claimed by the Petitioner. This resulted in reduction in value of gas internally consumed by Rs. 182 million as per short order dated May 21, 2003. However, taking into account the impact of uniform cost of input gas per Federal Government Policy Guideline received on June 18, 2003, the value of gas**

internally consumed has been increased by Rs. 99 million over and above that previously determined. The consequential adjustment is also being made in the cost of gas sold and sales revenues.

29.3 Therefore, the Authority provisionally allows internal consumption of gas for FY 2003-04 at Rs. 920 million as against Rs. 821 million as per determination dated May 21, 2003, subject to actualization.

UNACCOUNTED FOR GAS LOSSES (UFG)

30 The Petitioner has projected to decrease UFG from 7.02% (26,645 MMSCF) for FY 2002-03 to 6.5% (32,940 MMSCF) for FY 2003-04.

DESCRIPTION	FY 2003-04	FY 2002-03	FY 2001-02
Gas Purchases net of internal consumption	508,374	379,235	349,871
Gas Sales	475,434	352,590	321,957
UFG	32,940	26,645	27,914
UFG % (%age of Purchases)	6.50%	7.02%	7.98%

30.1 The Petitioner is implementing its plan for reduction of UFG to the level directed by the Authority (i.e. UFG @ 6% by June 2005) by rectification of leakages, replacement of old meters in a phased manner, surprise visits to the consumer premises in order to check gas theft, upgrading of measurement facilities and enhanced maintenance of gas network.

30.2 In its determination of August 8, 2002, the Authority had directed the Petitioner to reduce its line losses i.e. Unaccounted for Gas (UFG) to 6% by June 2005. **The Petitioner has estimated the UFG @ 6.5% for the FY 2003-04. The Authority accepts the same and decides that in order to incentivise the Petitioner to improve its efficiency and to safeguard the interest of the consumers, the Petitioner shall be entitled to retain the savings in case where the Petitioner improves upon the UFG targets of 6.5% in FY 2003-04. Conversely the Petitioner shall bear from its own profit the consequential impact of not achieving the afore-stated target of UFG**.

DECISION

31 In exercise of the powers vested in the Authority under the Oil and Gas Regulatory Authority Ordinance, 2002, the estimated revenue requirement for FY 2003-04 is now determined at Rs.67,439 million as against Rs. 65,042 million determined on May 21, 2003, tabulated below:

Estimated Revenue Requirement –Financial Year 2003-04

Rupees in million

Cost of Gas	55,955
Operating cost (T&D cost)	4,159
Gas internally consumed	920
Workers profit participation fund	169
Worker welfare fund	40
Depreciation	3,133
Return on net fixed asset in operation @ 17.5%	4,633
	69,009
Less other operating income:	
Rental and service charges	(640)
Surcharge and interest on gas arrears	(575)
Amortization of deferred credit	(355)
	(1,570)
Total estimated revenue requirement	67,439

32 In view of the above, the shortfall in the estimated revenue requirement of the Petitioner for FY 2003-04 at the current Prescribed Prices is estimated at Rs 6,574 million as against Rs.4,177 million determined vide order dated May 21, 2003. In order to meet the above estimated shortfall in revenue requirement, the Authority allows an increase in the average Prescribed Price of the Petitioner on provisional basis w.e.f. July 01, 2003 at the rate of Rs. 14.72 per MMBTU (**worksheet at Annexure-A)**. The revised Prescribed Price for each category of retail consumers for FY 2003-04, effective from July 01, 2003, is determined on provisional basis as per **Annexure-B**. **Since the rationalization of Sale Price for domestic consumers fall within the exclusive jurisdiction of Federal Government, the Prescribed Price in the case of domestic consumers has been kept unchanged as the same is already at par with the existing Sale Price.** Similarly no change has been made in the case of fertilizer feed stock (new plants) as the same has been frozen for a period of 10 years, which will expire in 2008. The Prescribed Price of feedstock gas for old fertilizer plants has been increased by 7.5% in order to bring it at par with the new sale price of such gas w.e.f. 1.7.2003 as per Fertilizer Policy, 2001.

DIRECTIONS

33 The Authority hereby reiterates its earlier directions given to the Petitioner to:

a. ensure prudency in its capital expenditure and starting from FY 2002-03 provide detailed justification of various additions to the rate base.

b. lay transmission lines or distribution spurs to a new town / area prior to laying distribution network

c. progressively reduce UFG to below 6%, within three years, starting financial year 2002-03, subject to decision at para 30.2 above.

d. conclude agreement with CBA on the basis of principles enunciated in the determinations dated August 8, 2002 and March 12, 2003 of the Authority.

e. 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.

f. takeup the recovery of WAPDA's interest on gas bill arrears at appropriate forum.

g. seek directions of the Federal Government on the issue of non-recognition of late payment surcharge from WAPDA as income.

h. compute cost of gas on the basis of wellhead prices notified by the Authority.

i. create separate funds to meet its obligations under International Accounting Standard-19.

28.1 In addition the Authority further directs the Petitioner to conclude agreement with the Sui Southern Gas Company Limited by July 31, 2003 ensuring prompt gas purchase differential settlement mechanism in accordance with the Policy Guideline issued by the Federal Government, subject to the approval of the Authority, as discussed in para 10 above.

29 This detailed determination incorporate the short order dated May 21, 2003 as changed on June 27, 2003.

(Mahboob Elahi) Member (Finance)	(Rashid Farooq) Member (Oil)	(Jawaid Inam) Member (Gas) / Vice

Chairman

(Munir Ahmad)
Chairman

Islamabad
Monday, June 30, 2003

Annexure-A Determination of estimated revenue requirements for FY 2003-04

Annexure-B Provisional Prescribed Prices for FY 2003-04 w.e.f. July 1, 2003

Annexure-B Page -2

Annexure-C List of Participants

Below is a list of participants and their representatives that participated actively, through intervention at the public hearing, or by filing argument:

SNGPL Mr. Abdul Rashid Lone
Mr. Ghulam Qadir Awan
Mr. Imran Wasti
Mr. Aslam Khawaja

NGPCL Mr. Irfan Rafique Butt
Mr. Shahzad Awan

WAPDA (PPO) Mr. Muhammad
Akbar Mr. M Azam Khan
Shad
CRCP Mr. Aftab
Alam Mr. Mazhar
Siraj Mr. Farhan
Ahmed

KSE Mr. Zafar Abdullah

APTMA Mr. Anis ul
Haq

Others that commented on or observed this proceeding were:

Mr. Malcom Clampin *KAPCO* vide letter dated April 26, 2003

Mr. Nasim Beg *Arif Habib Securities* vide letter dated April 21, 2003

Mr. Attiq ur Rehman *Fauji Kabirwala Power Company Limited* vide letter dated April 25, 2003

Agha Mujeeb Ahmed Khan *Agha Mujeeb & Co.*

Qazi Muhammad Ilyas

Annexure-D Abbreviations used in the determination

APTMA	*All Pakistan Textile Mills Association*
BTU	*British Thermal Units*
CBA	*Collective Bargaining Agent*
CRCP	*Consumer Rights Commission of Pakistan*
DG (Gas)	*Directorate General of Gas*
FKPCL	*Fauji Kabirwala Power Company Limited*
FY	*Financial Year*
GDS	*Gas Development Surcharge*
GOP	*Government of Pakistan*
IAS	*International Accounting Standard*
IBRD	*International Bank for Reconstruction and Development*
IPP	*Independent Power Projects*
KAPCO	*Kot Addu Power Company Limited*
KM	*Kilometers*
KSE	*Karachi Stock Exchange*
LFA	*Leave fare assistance*
MCF	*Thousand Cubic Feet*
MMBTU	*Million British Thermal Units*
MMMBTU	*Billion British Thermal Units*
MMSCF	*Million Standard Cubic Feet*
MMSCFD	*Million Standard Cubic Feet per day*
MP&NR	*Ministry of Petroleum and Natural Resources*
NPGCL	*National Power Generation Company Limited*
OGRA	*Oil and Gas Regulatory Authority*
OGRA Ordinance	*Oil and Gas Regulatory Authority Ordinance 2002*
PPL	*Pakistan Petroleum Limited*
PPO	*Power Privatization Organization*
ROA	*Return on Assets*
Rs.	*Pakistani Rupee*
SNGPL	*Sui Northern Gas Pipelines Limited*
SSGCL	*Sui Southern Gas Company Limited*
T&D	*Transmission and Distribution*
UFG	*Unaccounted for gas*
W P Fund	*Workers profit participation fund*
WAPDA	*Water and Power Development Authority*