Case No. OGRA-6(2)-2(1)/2006- (Review)

IN THE MATTER OF

SUI SOUTHERN GAS COMPANY LIMITED
MOTION FOR REVIEW OF ERR, FY 2006-07

UNDER

OIL AND GAS REGULATORY AUTHORITY ORDINANCE, 2002 AND NATURAL GAS TARIFF RULES, 2002

DECISION

September 27, 2006

Before:

Jawaid Inam, Member (Gas) / Vice Chairman
Rashid Farooq, Member (Oil)
M.H. Asif, Member (Finance)

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1. BACKGROUND

1.1. Sui Southern Gas Company Limited (the petitioner) is a public limited company incorporated in Pakistan, which is listed on the Karachi, Lahore and Islamabad Stock Exchanges. The company is engaged in construction and operation of gas transmission & distribution pipelines, sale of natural gas & gas condensate as a by-product, and manufacture & sale of gas meters.

1.2. The petitioner submitted a review motion (the review motion) on June 16, 2006 under Rule 16 of the Natural Gas Tariff Rules, 2002 (NGT Rules, 2002) for increase in the prescribed prices of various categories of consumers, which were determined by the Authority as a sequel to its order dated May 20, 2006, determining Estimated Revenue Requirement (ERR) of the petitioner for FY 2006-07 at Rs. 87,713 million under Section 8(1) of the Oil & Gas Regulatory Authority Ordinance, 2002 (the Ordinance) in case No. 6(2)-2(5)/2005. (These prescribed prices were subsequently readjusted on the basis of sale prices as advised by the Federal Government and notified by the Authority on June 30, 2006) as shown in relevant column of Annexure-B.

1.3. The petitioner has requested for increase of Rs. 2,707 million in its determined ERR of FY 2006-07, through average increase in the prescribed prices of Rs. 7.59 per MMBTU, and has submitted the following comparative statement of cost of service:

Table 1 : Comparison of Cost of Service per the Review Motion with ERR

Rs./MMBTU

Particulars	FY 2006-07 DERR	FY 2006-07 The Review Motion
Units sold BBTU	**360,741**	**356,731**
Cost of gas sold	211.72	214.11
Unaccounted For Gas(in excess of OGRA benchmark)	(0.64)	-
Transmission and distribution cost	12.24	14.48
Depreciation	6.62	6.69
Return on net average operating fixed assets	11.72	11.85
Other operating income	(12.65)	(11.06)
Contribution to W.P.F	0.48	0.63
Deferral account	1.00	1.01
Cost of service / prescribed price	**230.50**	**237.71**
Existing Prescribed Price	230.50	230.11
Increase requested in the prescribed price	**0.00**	**7.59**

1.4. The Authority, on July 24, 2006, issued a notice of conference in terms of Rule 6 of NGT Rules, 2002, to the petitioner, interveners and the Federal Government.

2. PROCEEDINGS

2.1. Conference

2.1.1. The Authority held the conference at Karachi on August 22, 2006, in which the following participated:-

Petitioner

i) The Petitioner was represented by a team led by its Managing Director, Mr. Munawar Baseer Ahmed.

Interveners

ii) Mr. Nisar Shekhani, Representative, S.I.T.E. Association Industry

iii) Mr. Younus Bin Ayub, Representative, Pakistan Hosiery Manufacturer Association.

iv) Mr. Muhammad Arif Bilvani, Representative, Mushtaq & Company (Pvt.) Limited.

Federal Government

v) Mr. Tahir Ali Shah, Joint Secretary, Cabinet Division.

2.2. Petitioner's Submissions

2.2.1. The petitioner made submissions in detail in support of the review motion with the help of multimedia presentation. The petitioner submitted that it had reviewed its review motion, and had reduced its request for increase in ERR to Rs. 88,743 million and average increase in prescribed prices to Rs. 4.56 per MMBTU.

2.2.2. The petitioner pleaded that in view of the ground realities and for ensuring reasonable return to shareholders including minority shareholders, the Authority should review the UFG targets set by it, and allow UFG upto 6.6% for FY 2006-07. The petitioner contended that UFG target below 6% was simply unachievable in the local operating conditions.

2.2.3. The petitioner requested that income not directly related to gas operations including royalty from JJVL, meter manufacturing profit and late payment surcharge be treated as "non-operating" accepting its long-standing contention.

2.2.4. The petitioner submitted that relatively insignificant expenditure relating to preliminary work on making import of LNG possible, be allowed, which was planned on "Build Own and Operate" basis. It would facilitate meeting the continuously increasing requirement of natural gas, particularly in Karachi. The petitioner also highlighted that gap between demand and supply was widening, making import of gas and LNG imperative if the company's mission of sustainable and un-interrupted gas supply was to be ensured. The petitioner emphasized that expenditure on this score was a legitimate part of the revenue requirement and should be accepted as such.

2.2.5. The petitioner urged that un-metered gas losses on account of accidents, third party damages and blow offs be allowed as part of Gas Internally Consumed (GIC) in keeping with the practice being followed in different parts of the world. The petitioner submitted that these were normal operational losses beyond its control in undertaking repair & maintenance, rehabilitation, purging etc.

2.2.6. Managing Director, ISGSL, Syed Hassan Nawab, briefly presented an update about various measures being taken to contract additional supply of gas, through import as LNG or piped gas.

2.3. **Summary of Interveners' Submissions / Written Comments**

2.3.1. UFG target as set by the Authority should be enforced. Theft from the high pressure pipelines is not possible without connivance of the petitioner's own employees. It is morally unjustified to burden the honest consumers with the financial loss from gas theft.

2.3.2. Meter manufacturing profit, late payment surcharge and royalty from JJVL are operating incomes, and should not be allowed to be treated as non operating income.

2.3.3. The wellhead gas prices for Qadirpur and Kadanwari fields, which are unusually high, have not been brought down by the Federal Government even though this issue was taken up by the interveners in the earlier hearings in April 2006. The Federal Government should take necessary action in this regards urgently.

2.3.4. There is no rationale for giving any CPI adjustment on HR benchmark, since HR benchmark continues to automatically increase with increase in number of consumers, sales volume and network expansion.

2.3.5. The guaranteed rate of return on assets, currently being offered to the petitioner, is too high and must be brought down.

2.3.6. The Federal Government should do away with the cross-subsidy in favour of domestic and fertilizer feed-stock consumers at the cost of the industrial consumers.

2.3.7. Cost of gas must be brought down. In Bangladesh, gas is being supplied at 40% and 60% of Pakistan's gas tariff in case of captive power and industrial consumers, respectively.

2.3.8. Most of the knitting units, which were exporting products exceeding one billion US dollars, have already been shut down having been pushed out of the international market, due to high utility prices.

2.3.9. Taxes must be reduced on gas prices, if industry is to stay competitive in post WTO environment.

2.3.10. It is not justified that the petitioner has sought an increase of Rs. 23.9 million on account of rationalization of fixed and variable charges, even though it had earlier claimed that the same will not impact their revenue requirement. It had not provided detailed working of the claimed impact.

2.3.11. The petitioner had earlier been charging Rs. 60/- as meter rent from the industrial consumers regardless of consumption. There is no justification for now increasing it, in certain cases, by fifty times, to Rs. 3,000/-.

2.3.12. The present minimum monthly bill of Rs. 8,123/- and Rs. 1,279/- for industrial and commercial consumers respectively, is on higher side and should be brought down.

3. HUMAN RESOURCE COST

3.1. Petitioner's Request and Grounds for Review

3.1.1. The petitioner has repeated its earlier request to allow inflationary adjustment at 70% of CPI instead of 50% pleading that the saving on account of efficiency gain, of more than 30%, is not achievable.

3.1.2. It has further re-iterated that the Authority may revisit the methodology of computing HR cost benchmark, as it is inconsistent with the wording of its decision per para 8.2.3 on motion for review for FY 2005-06 dated October 19, 2005.

3.1.3. The petitioner has also stated that its executives' perquisites were subject to revision in 2004, but have not yet been revised. The benchmark HR cost, allowed by the Authority, is not flexible enough to absorb such revision in addition to regular increments essential to retain quality executives in the organization. Moreover, a recent study conducted by M/s A.F. Ferguson & co. concluded that the perquisites offered by SSGCL to its staff are at around 25 percentile of the market, in oil and gas sector. Therefore, in order to retain quality workforce, the perquisites need upward revision.

3.1.4. The petitioner has requested the Authority to allow HR benchmark cost at Rs. 3,552 million instead of 3,311 million, determined per ERR 2006-07.

3.2. Discussion & Decision

3.2.1. The Authority observes that it had decided the extent of inflationary adjustment after deep consideration and analysis of views of all stakeholders including the petitioner. The petitioner has merely repeated itself and has not presented any new evidence to warrant review of the earlier decision. As regards the matter of methodology of calculating CPI for HR cost benchmark, it was elaborately dealt with in the Authority's decision on the petitioner's motion for review for FY 2005-06 and ensuing correspondence, and nothing new has been said by the Petitioner.

The Authority, therefore, maintains its earlier decision per ERR 2006-07 of allowing HR benchmark cost at Rs. 3,311 million.

4. COST OF GAS

4.1. The Authority observes that in the ERR for FY 2006-07, Weighted Average Cost of Gas (WACOG) was estimated at Rs. 192.55 per MMBTU, estimating the wellhead gas prices for Qadirpur field at Rs. 263.12 per MMBTU.

4.2. Qadirpur wellhead Gas Pricing Agreement provides schedule of discounts applicable at six monthly average price of High Sulfur Fuel Oil (HSFO) at various levels, with a maximum of 45% at HSFO Average Price of US$ 200 per ton. Clause 4.1(b) of this agreement further provides that the rates of discount will be revised by the parties in case six monthly average price of HSFO escalates beyond US $ 200 per ton. The average C&F price of HSFO for the six-months, period-December, 2005 to May, 2006, worked out to US $ 316.9174 per ton, and the Ministry of Petroleum and Natural Resources, vide its letter No. DGO(AC)-5(78)/2006 dated 29th July, 2006, has conveyed the revised schedule of *provisional* discounts for determining the Qadirpur wellhead gas price. The wellhead gas price for Qadirpur field effective July 01, 2006, has accordingly been notified by the Authority on August 21, 2006 at Rs. 162.54 per MMBTU. Earlier, however, for the purpose of inclusion of cost of Qadirpur gas in ERR for FY 2006-07, the wellhead price was projected taking 45% maximum discount.

4.3. ***On the basis of notified wellhead gas prices, effective July 01, 2006 as well as revised estimated wellhead gas prices for the period effective January 01, 2007, and taking into account revised provisional discount schedule, the WACOG for FY 2006-07 has been reworked by the Authority at Rs. 171.38 per MMBTU, resulting in decrease in revenue requirement of the petitioner, as far as cost of gas is concerned, by Rs. 8,339 million. Revised WACOG statement is at Annexure-D***.

5. GAS INTERNALLY CONSUMED (GIC)

5.1. Petitioner's Request and Grounds for Review

5.1.1. The petitioner has contested the Authority's decision to disallow Rs. 62 million relating to un-metered gas, and Rs. 28 million to shrinkage of gas.

5.1.2. The petitioner has argued that the un-metered GIC is inevitable, owing to gas purging/blow off during planned maintenance work, third party accidental pipeline rupture, sabotage activities, etc. The petitioner has gone on to say that, technically, it is possible to measure gas purged during planned maintenance of pipelines; tie-ins of new pipelines and blow off on transmission and distribution sites but the company will have to develop mobile metering units for that purpose, which are not economically feasible. Therefore, it has to calculate the amount of gas loss by using standard formulae. Moreover, all such activities are part of normal pipeline operation and can not be termed as unaccounted for gas (UFG).

5.1.3. The petitioner has also referred to the definition of UFG adopted by States of Louisiana and California of USA, allowing adjustments for gas blown offs, purging, etc. Moreover, at the time of fixing UFG target, the Authority had included un-metered purging losses in GIC, and, therefore, disallowing the same is against the spirit of regulation.

5.1.4. The petitioner has stressed that losses due to sabotage activity on pipeline network have been claimed because earlier also, OGRA, in its decision on review motion for total revenue requirement for FY 2003-04, has allowed Rs. 11.6 million on account of accidental losses not covered under insurance policies. Had those losses been covered, under insurance policies, the premium would have increased by Rs. 99 million.

5.1.5. The petitioner has contended that its distribution network is spread over two provinces where pipelines are passing along side other amenities, and they are frequently damaged by other civic agencies while working on their own networks, resulting in loss of gas.

5.1.6. The petitioner has further contested that the disallowance of expenditure of Rs. 28 million on account of gas condensate is not justified as the Authority has accounted for the recovery aspect of the same transaction. In case the claim as GIC is not considered justified, then it may be allowed as cost against recoveries of condensate.

5.1.7. The petitioner has requested the Authority to review the matter and formalize some standard methods for the calculation of un-metered gas to determine the quantum of GIC.

5.2. Discussion and Decision

5.2.1. The petitioner has not advanced any new evidence or arguments in support of its contention about un-metered gas.

5.2.2. The Authority observes that gas losses on account of blow offs, purging, third party damages, etc., can not be allowed as part of GIC, since the same are not measured and, in any case are negligible in the overall context. The Authority however took into account such technical losses as well as the ground realties in respect of operating conditions while prescribing rather liberal UFG target range of 5.4% to 6% for FY 2006-07, even though, internationally, UFG for integrated transmission and distribution companies is typically around 3%.

5.2.3. The Authority will decide the matter of losses on account of alleged sabotage activities at the time of determination of FRR for FY 2006-07.

5.2.4. The petitioner's plea that OGRA has taken into account income from sale of gas condensate, while ignoring the expenditure side (i.e. cost of gas) is tenable. ***The Authority, therefore, allows addition to cost of gas amounting to Rs. 24 million (calculated on the basis of revised WACOG as mentioned in para 4.3 above).***

6. POSTAGE & REVENUE STAMP

6.1. Petitioner's Request and Grounds for Review

6.1.1. The petitioner has submitted that to award the work of distribution of gas bills at competitive price, it had invited bids from the conventional specialized bill delivery contractors but the basic objective of timely delivery of gas bills to customers could not be achieved as the successful bidders quoted unrealistically low prices and then compromised the quality of service. In order to ensure timely delivery of gas bills at the doorstep of the customer, the petitioner has since pre-qualified established courier companies having delivery network all over Sindh and Baluchistan, based on specified terms of reference including penalty clauses for non-performance. Terms of Reference now include compliance with OGRA's performance standards like assurance of bill delivery to customers allowing minimum of 7 days for payment, tolerance limit for non delivery, etc.

6.1.2. The petitioner has stated that since it has already entered into contracts with the courier service, disallowance of these expenses will put the petitioner in reverse gear and the quality of service in this sector will be compromised.

6.1.3. The petitioner has requested to allow Rs. 73 million as claimed in the petition per ERR 2006-07 instead of 41 million allowed by the Authority.

6.2. Discussion and Decision

6.2.1. ***The Authority after taking into account the petitioner's plea of claiming the increased gas bill distribution charge, provisionally allows the same at Rs. 73 million for the said year, subject to the condition that the petitioner would provide evidence of actual improvement in quality of service by December 2006.***

7. REPAIRS AND MAINTENANCE CHARGES

7.1. Petitioner's Request and Grounds for Review

7.1.1. The petitioner has contested the Authority's decision of disallowing Rs. 67 million in respect of repair and maintenance charges, on the ground that the company has already claimed Rs. 237 million under the head of addition to buildings which included its construction, extension, establishment and renovation work. Repair and maintenance is, however, an operational requirement.

7.1.2. The petitioner has stated that it has its own distribution offices in major cities and 8 operational headquarters for transmission system with residential accommodations for operational staff. Beside this, the petitioner has a number of rented buildings which require ongoing repairs. Further, new buildings when taken on rent need renovation.

7.2. Discussion and Decision

7.2.1. The Authority observes that the petitioner's contention that this expenditure is not of capital nature and meets an essential operational requirement is tenable.

7.2.2. ***The Authority, therefore, provisionally allows Rs. 67 million on account of repair and maintenance of buildings.***

8. GAS BILL COLLECTION CHARGES

8.1. Petitioner's Request and Grounds for Review

8.1.1. The petitioner has stated that an amount of Rs. 77 million was allowed by the Authority against its estimates of Rs. 154 million under the head "Bill Collection Charges". The petitioner has informed that State Bank of Pakistan (SBP) has agreed to enhance the bill collection charges to Rs. 8/- per bill w.e.f 1st July, 2006, with provision for revision after every two years. Based on this decision, bill collection charges have been reworked by the petitioner at Rs. 124 million. The petitioner has requested to allow the same.

8.2. Discussion and Decision

8.2.1. The Authority had provisionally allowed Rs. 77 million on this account in ERR 2006-07, subject to finalization of revised rate by State Bank of Pakistan (SBP). SBP, in the meeting held with the representatives of major banks and utilities on June 08, 2006, has decided to fix the bill collection charges of major commercial banks at Rs. 8/= per bill as against their demand at Rs. 10 per bill. However, this decision does not apply to smaller banks, and other agencies handling this work.

8.2.2. The Authority has noted that about 80% bills are deposited in major banks and the remaining 20% in smaller banks and with other agencies.

8.2.3. ***The Authority directs the petitioner to make its best efforts for full implementation of the decision of State Bank of Pakistan fixing the bill collection charge at Rs. 8/- per bill, and partially accepting the petitioner's request, provisionally determines the projected Gas Bill Collection Charges for FY 2006-07 at the revised estimated figure of Rs. 114 million.***

9. SHARE IN EXPENDITURE OF INTERSTATE GAS COMPANY LIMITED (ISGSL)

9.1. Petitioner's Request and Grounds for Review

9.1.1. The petitioner has requested the Authority to allow Rs. 146 million on account of 51% share in expenditure of ISGSL, as these expenses are being incurred on behalf of GoP, which will benefit the existing and prospective consumers of the petitioner by reducing the demand supply gap in future. Such expenditure is, therefore, prudent and well justified.

9.1.2. The petitioner has argued that these expenses are approved by the Board of Directors (BOD) of SSGCL, SNGPL and ISGSL, which includes members from Ministry of Petroleum, Finance and Foreign Affairs. Hence, the concurrence of Ministry of Finance on these expenses is available.

9.1.3. The petitioner also presented minutes of the meeting on "Gas Import Options" held on January 27, 2005, chaired by the Prime Minister in which it was decided that a financial advisor be urgently hired by ISGSL and has stated that this was one of the major expense item.

9.1.4. The Ministry of Petroleum and Natural Resources in a letter to the Authority, dated September 05, 2006, has supported this plea of the petitioner.

9.2. Discussion & Decision

9.2.1. During the conference, Managing Director, ISGSL, informed the Authority that budget estimates for FY 2006-07 have been reviewed and revised downward by the ISGSL Board of Directors. The petitioner, however, accepted that it had not accounted for this reduction in the review motion. Later on, the petitioner informed that its share in ISGSL,s expenditure for FY 2006-07 has been reduced to Rs. 96 million.

9.2.2. The Authority reviewed the legal position in regard to projected expenditure relating to services provided by ISGSL, and observes that it qualifies as part of revenue requirement pursuant to Sub-Rule (iv) of Rule 17 of NGT Rules, 2002, which is reproduced below:-

> *"tariffs should be determined in a manner which promotes* ***continued*** *reasonable investment in equipment, facilities and research and development for qualitative and* ***quantitative*** *improvement in the provision of regulated activities:"(emphasis added)*

9.2.3. The expenditure being incurred by the petitioner is likely to increase supply of gas which will enable the petitioner to meet shortfall, envisaged around the year 2010, and increase revenues.

9.2.4. The Authority, however, observes that it has no means of ascertaining the prudence, propriety and transparency of expenses incurred by ISGSL and, therefore, had earlier stated that the expenditure incurred in respect of ISGSL, may be scrutinized and approved by the Ministry of Finance (MoF) for inclusion in the petitioner's revenue requirement.

9.2.5. The Authority further notes that nature and limitations of disbursements by the petitioner to ISGSL is not well defined in the agreement with ISGSL. The scope of services to be rendered by ISGSL, for which the petitioner is obligated to make the payments, is also vague.

9.2.6. The Authority notes that the Prime Minister has already decided that the Financial Advisor should be engaged by ISGSL on urgent basis.

9.2.7. ***The Authority, provisionally, accepts the expenditure of Rs. 96 million for FY 2006-07, subject to the following conditions:***

(i) The petitioner will revise the service agreement with ISGSL by December 31, 2006 to clearly spell out its rights and obligations as well as the respective roles / responsibilities of the Board of Director's of the petitioner and ISGSL in the matter of approving expenditure of ISGSL ensuring its reasonability and prudence. The classification of funds provided by the petitioner to ISGSL i.e. equity, loan or grant per applicable rules / regulations should be clearly identified in the revised agreement;

(ii) Since the Federal Government is the major stakeholder in the gas import project providing not only the policy guidelines but also directly supervising the project and leading all negotiations, the Service Agreement should also be approved by the Federal Government.

10. REVENUE EXPENDITURE RELATING TO LNG PROJECT

10.1. Petitioner's Request and Grounds for Review

10.1.1. The petitioner has requested to allow Rs. 80 million projected to be incurred on developing LNG project to cope with natural gas shortfall envisaged by the year 2009-10. This project has also been approved by the President and the Prime Minister of Pakistan so that uninterrupted supply of gas to the consumers in the long run is assured.

10.1.2. The petitioner has provided copy of minutes of a meeting on "gas import option" held on January 27, 2005, chaired by the Prime Minister. In the said meeting, it was decided that the petitioner should urgently hire Financial Advisor (investment banker) in accordance with Privatization Commission Rules, to prepare and process the LNG project.

10.1.3. The petitioner has further argued that such expenses are per GoP policy being project development expenditure as ultimate beneficiaries of the project are the consumers. It was also stated that during the presentation on "Energy Security Action Plan", on February 15, 2005, the President and the Prime Minister gave certain directions / observations which *inter alia* included allowing and facilitating gas utilities to import LNG through private sector on BOO/BOT basis to meet the gas shortfall upto 2010 and continue to fulfill the gap, thereafter, with no Government guarantees.

10.2. Discussion & Decision

10.2.1. The Authority observes that the petitioner is primarily operating as a project development vehicle, since the project ultimately is to be setup and operated in the private sector, per the directions of the Federal Government.

10.2.2. The Authority notes that it has no means of ascertaining prudence, propriety and transparency of expenditure incurred under this head since the Federal Government, is directly supervising the LNG project and leading the negotiations.

10.2.3. The Authority further observes that the petitioner should ensure compliance of Public Procurement Rules 2004 (PPR 2004), in appointment of the Financial Advisor to conduct study on the project, as it will have a direct impact on the revenue requirement of the petitioner and consequential increase in the prescribed price of the consumers.

10.2.4. ***In view of the above, the Authority provisionally allows the projected expenditure of Rs. 80 million on this account for the said year, subject to the approval of the same by the Federal Government, prior to the close of FY 2006-07.***

11. OTHER T&D EXPENSES

11.1. Petitioner's Request and Grounds for Review

11.1.1. The petitioner has requested the Authority to allow Rs. 22 million projected to be incurred on company's functions and in-house seminars. These programs are arranged for employees' benefits and motivational purposes, including medical awareness necessary to understand better ways of living, enhancing closer interaction for facilitating better communication and smooth work. These functions also provide platform to motivate employees on better performance and for award distribution on exceptional performance. These expenses are classifiable as operating expenses as these add value towards employees' welfare and efficiency.

11.2. Discussion & Decision

11.2.1. The Authority observes that this is the first time that the petitioner has related this expense to employee's welfare. No break up of these activities has been provided by the petitioner. The Authority notes that it has only disallowed Rs. 10.8 million per para 9.3.51 of ERR for FY 2006-07 on account of company's functions including banquets as against Rs. 22 million claimed by the petitioner. The additional amount of Rs. 10 million was provisionally disallowed on account of other miscellaneous expenditure of which no detail was provided and Rs. 0.7 million for printing of diaries, calendars, etc.

11.2.2. The Authority further notes that it cannot determine prudence and reasonability of the expenditure of Rs. 10.8 million, projected for petitioner's functions, in the absence of activity-wise details.

11.2.3. ***The Authority, therefore, provisionally disallows the claim about expenditure of Rs. 22 million. It will be considered at the time of FRR for FY 2006-07, subject to provision of activity wise detail and justification.***

12. FIXED & VARIABLE CHARGES

12.1. Petitioner's Request and Grounds for Review

12.1.1. The petitioner has submitted that although the Authority has kindly considered and approved these charges it did not include the financial impact of these charges in the tariff computation on the ground of being negligible. The petitioner has, therefore, requested to include the projected financial impact of these charges in revenue requirement to cover the shortfall of Rs. 23.9 million.

12.2. Discussion & Decision

12.2.1. The Authority observes that the petitioner has not provided the computations/break-up of projected amount on account of revised fixed and variable charges, and, in any case, at the time of determination of FRR, actual amounts will take care of this relatively minor factor.

12.2.2. ***The Authority, therefore, maintains its decision per determination of ERR for FY 2006-07.***

13. LEGAL CHARGES

13.1. Petitioner's Request and Grounds for Review

13.1.1. The petitioner has requested the Authority to revisit its decision per para 9.3.33 of ERR FY 2006-07, regarding disallowance of legal charges incurred by the company on attainment of redressal from higher courts of law against its decision. This decision will deprive the affectee of its constitutional and legal rights.

13.2. Discussion & Decision

13.2.1. The Authority has a duty to examine and decide allowability of an expense with reference to the evaluation criteria, laid down in Section 7 of OGRA Ordinance, 2002 and Rule 17 of NGT Rules, 2002. Each cost component of the revenue requirement cannot be specified in the law. The Authority has to make its judgment on case to case basis. The expenditure on litigation against the Authority's decisions is not prudent in the judgment of the Authority.

13.2.2. ***The Authority therefore, provisionally disallows expenditure pertaining to litigation with OGRA***.

14. STATUTORY AUDITORS' CERTIFICATE

14.1. Petitioner's Request and Grounds for Review

14.1.1. The petitioner has contested the decision of the Authority regarding provision of statutory auditors' certificate at the time of FRR confirming (i) the actual cost incurred on each item of capital expenditure, and (ii) the procurement has been carried out transparently and in accordance with the provisions of Public Procurement Rules (PPR 2004).

14.1.2. The petitioner has stated that the Authority, vide its order on motion for review of ERR for FY 2005-06, had relaxed the requirement of statutory auditors' certification on the request of the petitioner and had decided that the petitioner should provide statutory auditors' certificate based on detailed cost audit, confirming the cost that could be reasonably attributed to each asset capitalized during the year, on the basis of reasonable levels of efficiency and cost effectiveness, if it falls within any of the under-mentioned categories:

- **Transmission**
  - Construction Machinery
  - Pipelines (new / replacements)
  - Compression / turbines
  - SCADA
  - Telecommunications
- **Distribution:**
  - Pipelines (supply mains, extensions, etc.) excluding the jobs with total value of less than Rs. 10 million.

14.1.3. The petitioner has further stated that according to the Authority's decision on motion for review of ERR for FY 2005-06, statutory auditors' certificate shall also confirm procurement of assets and services being transparent, cost effective and in accordance with the PPR 2004, limited to the following;

- Construction machinery
- Pipelines
- Regulations
- Valve and Fittings
- Coat and Wrap Materials
- Compressors / Turbines
- SCADA
- Service contracts excluding those valued at less than Rs. 50 million.

14.1.4. The petitioner has requested the Authority to re-visit its decision in this regard and applicability of this directive for subsequent periods may be decided after proper cost benefit analysis and mutual consultation with respect to the results for FY 2005-06 and FY 2006-07.

14.2. **Discussion & Decision**

14.2.1. ***The Authority observes that it had directed the petitioner in its determination of final revenue requirement for FY 2005-06, dated September 25, 2006, to provide within three months of issuance of this Order, the requisite certificate to the satisfaction of the Authority. Further, if the statutory auditors express their inability to provide the same, practicing cost and management accountant and / or specialist procurement auditors be engaged for the purpose in accordance with the terms of reference earlier approved by the Authority, with prior approval of the Authority.***

14.2.2. ***The Authority directs the petitioner to comply the above-mentioned direction on account of provision of auditor's certificate.***

15. OTHERS

15.1. **Petitioner's Request and Grounds for Review**

15.1.1. The petitioner has stated that since the company is up for privatization, the following pending issues, affecting its revenue requirement need to be resolved, at the earliest:

- Late Payment Surcharge
- Meter Manufacturing Profit
- Royalty Income from JJVL
- UFG

i) Late Payment Surcharge and Meter Manufacturing Profit

15.1.2. The petitioner has stated that, while determining its revenue requirement the Authority is considering the Late Payment Surcharge and Meter Manufacturing Profit as operating income, in accordance with the Policy Guidelines issued to OGRA by the Federal Government. This guideline provides that till such time an appropriate rate of return is determined by OGRA, in consultation with the Federal Government and the licensees, OGRA shall determine the revenue requirements of existing gas companies on the basis of the covenants stipulated in the loan agreements of SNGPL with World Bank and of the petitioner with Asian Development Bank (ADB). The petitioner has further stated that due to inordinate delay in finalizing the issue, it has suffered a great deal on this account, affecting the earning per share of the company and resultantly its share price. The petitioner has requested to allow the Late Payment Surcharge and Meter Manufacturing Profit as non operating income.

15.2. **Discussion & Decision**

15.2.1. The Authority observes that this issue has already been settled in its earlier determinations in accordance with the Federal Government's policy guidelines, dated October 11, 2002, and the petitioner has not presented any new argument or evidence in this respect. The Authority has already proposed new tariff regime to Federal Government after consultation with the stakeholders. Pending its finalization, these incomes will continue to be treated as operating income.

ii) Royalty Income from JJVL

15.2.2. The petitioner has contended that the royalty from JJVL is a non-operating, non-core income. Further, ADB loan covenants also have defined the activities to be considered as operating income in general terms as "revenue from all sources related to operations would be considered as operating income", and no specific activities are named.

15.2.3. The petitioner has contested that according to International Accounting Standard (IAS) 7 the operating income means "principle revenue producing activity" and in its case, principle activity is the supply of gas and not royalty income from JJVL.

15.2.4. Further, in the OGRA Ordinance and Tariff Rules, Royalty income has not been included as regulated activity of utilities nor their license included this income from gas regulated activities. The Authority is, therefore, requested to allow royalty from JJVL as income from non-core, non-regulated activity.

15.3. **Discussion & Decision**

15.3.1. The Authority notes that, under the rules, the petitioner can submit the review motion on only such issues which have been decided by the Authority in the ERR for FY 2006-07 and from which the petitioner feels aggrieved. The issue of royalty income from JJVL was not brought up by the petitioner at the time of submission of its petition for ERR for FY 2006-07; hence the principle of estoppel is applicable. However, even, on merit, the petitioner's arguments hold no water. This income arises from the use of assets / system relating to regulated activities of transmission and sale of gas, and hence is "operating" income.

iii) Unaccounted for Gas (UFG)

15.3.2. The petitioner has stated that at the time of filing the petition for ERR for FY 2006-07 in November 2005, it was expected that the company would be able to achieve the UFG level of 6% during FY 2005-06, but by the end of April 2006 the UFG level of the company was around 7% and the penalty, if inflicted, will wipe out the profit of the company to a great extent.

15.3.3. OGRA, in its decision on motion for review of ERR FY 2005-06 dated October 19, 2005, had fixed the UFG target at 5.4%-6% for FY 2006-07. At the time of fixing the UFG target, the Authority did not include such measured / un-metered internal consumption in UFG which is unjustified. Moreover, definition of UFG under Rule 2(1)(m) of NGT Rules, 2002, also allows the adjustments of gas volume for losses from construction, pigging, line ruptures, etc. The Rule reads as under:-

"*UFG means, in respect of a financial year, the difference between the total volume of metered gas received by a licensee during that financial year and the volume of natural gas metered as having been delivered by the licensee to its consumers excluding there from metered natural gas used for self consumption by the licensee for the purpose of regulated activity* ***and such other quantity as may be allowed by the Authority for use by the licensee in the operation and maintenance of its regulated activity***."

15.3.4. The petitioner also referred the definition of UFG per States of Louisiana and California of USA which also allow the adjustment on account of variations in temperature, pressure, meter-reading cycles, heat content, calculable losses from construction, purging, line break, etc.

15.3.5. The petitioner also referred to the study conducted by Institute of Gas Technology Chicago, based on survey of ten gas utilities of the USA, which has given the following index:

> "*As a Rule, an annual percent of unaccounted for gas of 1% to 3% is considered low, between 3% to 6% is considered reasonable, and amount over 6% could indicate excessive leakage*".

15.3.6. Unlike USA & Europe, the operating conditions and ground realities in Pakistan are far adverse due to non availability of latest technology and social attitude of the customers. People in Pakistan do not bother to report leakages even in their own premises; in fact they contribute towards UFG by damaging the area network, while digging for any reason. Gas theft is also one of the major contributing factors of UFG in view of the ever increasing gas price. Pipeline system in villages cannot be patrolled to control theft through line pinching, meter tempering and direct connections from service valve which has become very frequent, and is difficult to detect. Moreover, keeping in view the tribal culture in certain areas of Sindh and Balochistan and absence of any protective security measure, it is difficult to combat this problem.

15.3.7. The petitioner has also stated that it has worked hard during the past few years to control the menace of UFG through rehabilitation of leaking mains and services, reinforcement of existing network, increase in overhead and underground leak surveys, replacement of old / slow / PUG meters of all category of customers, protective maintenance of transmission / distribution pipeline, coat / wrap of network, etc.

15.3.8. In view of the above, the petitioner has requested the Authority to review the UFG benchmark and re-fix the same at 7% upto 2006-07 for consolidation of efforts after which it may revert back to the Authority for reviewing the target downward.

15.4. **Discussion & Decision**

15.4.1. The Authority observes that for the first time, it was on August 06, 2002 that it had directed the petitioner, while determining ERR for FY 2001-02, to endeavor to reduce the UFG progressively to below 6% in three years, commencing from financial year 2002-03. Had the petitioner undertaken necessary measures, with due sense of urgency coupled with persistence, from then onwards, the UFG levels could have been brought down to the targeted, or even lower, levels, resulting in additional profits for its shareholders.

15.4.2. The Authority observes that it had set the UFG benchmark after exhaustive survey of international practices and consultation with the utilities. The arguments advanced now are not new and have already been discussed elaborately in Authority's previous decisions including the motion for review of ERR 2005-06 dated October 19, 2005. Further, the petitioner, itself, while submitting the petition for ERR FY 2006-07, had netted off Rs. 255 million on account of UFG above the benchmark, and cannot now take a contrary position. The principle of estoppel applies.

15.4.3. ***In view of the above, the Authority maintains its earlier decision of allowing UFG in accordance with the target set by the Authority for FY 2006-07.***

16. WORKERS PROFIT PARTICIPATION FUND (W.P.P.F.)

16.1. The petitioner has claimed WPPF at Rs. 215 million. ***However, due to adjustments in the components of revenue requirements as discussed above, WPPF is recalculated and allowed at Rs. 150 million.***

17. DETERMINATION

17.1.1. In view of the justifications submitted and arguments advanced by the petitioner in support of its review motion, points raised by the interveners, scrutiny by the Authority and detailed reasons recorded in earlier paragraphs, the Authority recapitulates and decides to:

17.1.1.1. maintain the HR benchmark cost at the level of ERR 2006-07 i.e. Rs. 3,311 million, as against Rs. 3,552 million claimed by the petitioner;

17.1.1.2. reduce the cost of gas to Rs. 68,039 million as against Rs. 76,378 million per ERR 2006-07;

17.1.1.3. reduce the cost of GIC to Rs. 173 million as against Rs. 258 million, claimed by the petitioner;

17.1.1.4. allow postage and revenue stamps expenditure at Rs. 73 million, as claimed by the petitioner, subject to conditions laid down in para 6.2.1 above;

17.1.1.5. revise repair and maintenance expense at Rs. 410 million as claimed by the petitioner;

17.1.1.6. revise the bill collection charges at Rs. 114 million as against Rs. 124 million claimed by the petitioner ;

17.1.1.7. allow Rs. 96 million on account of petitioner's share in expenditure of ISGSL, subject to conditions laid down in para 9.2.7 above;

17.1.1.8. allow Rs. 80 million on account of revenue expenditure relating to LNG project;

17.1.1.9. maintain the Other T&D expenses at the level of ERR FY 2006-07 i.e. Rs. 80 million, as against Rs. 100 million claimed by the petitioner;

17.1.1.10. maintain its decision per ERR FY 2006-07 in respect of fixed and variable charges;

17.1.1.11. maintain its decision per ERR 2006-07 in respect of legal charges;

17.1.1.12. continue treatment of LPS, meter manufacturing profit and royalty from JJVL as operating income;

17.1.1.13. disallow Rs. 255 million on account of UFG, over and above the benchmark set by the Authority; and

17.1.1.14. determine the W.P.P.F at Rs. 150 million.

17.1.2. In exercise of its powers under the Ordinance and NGT Rules, the Authority determines the estimated revenue requirement for FY 2006-07, at Rs. 79,643 million (as tabulated below), as against Rs. 88,743 million claimed by the petitioner in the review motion, thereby reducing the estimated revenue requirement by Rs. 9,099 million.

Table 2 : Components of the revenue requirement determined by the Authority

Serial No.	Particulars	Rs. in million
1	Cost of gas sold	68,039
2	Unaccounted For Gas(in excess of OGRA benchmark)	(255)
3	Transmission and distribution cost	4,553
4	Gas Internally consumed	173
5	Depreciation	2,388
6	Return on net average operating fixed assets	4,228
7	Contribution to W.P.P.F	158
8	Deferral account	360
	Total Estimated Revenue Requiremnt	**79,643**

17.2. The provisionally allowed expenses are subject to adjustments on the basis of review under Section 8(2) of the Ordinance, and later after scrutiny of auditors' initialed accounts of the petitioner for FY 2006-07, provided these expenses are substantiated with appropriate justification and analysis in the form acceptable to the Authority.

17.3. The revised provisional estimate of the petitioner's net operating income is at Rs. 87,712 million as against revenue requirement of Rs. 79,643 million and to adjust the difference of Rs. 8,069 million, the Authority hereby makes downward revision of Rs. 22.37 per MMBTU in the petitioners' average prescribed price for FY 2006-07, on provisional basis **(Annexure-A)** .

17.4. The Authority considers it important and essential to impress upon the petitioner that this provisional determination of estimated revenue requirement for FY 2006-07 pre-supposes that the petitioner would, in any case, faithfully and with responsibility conduct its affairs in full compliance of the requirement of Rule17(1)(h) & Rule 17(1)(j) of the NGT Rules, as reproduced below:

Rule 17(1)(h)

"*tariffs should generally be determined taking into account a rate of return as provided in the license,* ***prudent*** *operation and maintenance costs, depreciation, government levies and, if applicable, financial charges and cost of natural gas;"*

Rule 17(1)(j)

"only such capital expenditure should be included in the rate base as is ***prudent, cost effective*** *and* ***economically efficient****;"*

17.4.1. Provisional revised prescribed prices for each category of consumers for FY 2006-07, effective July 1, 2006, are attached as **Annexure-B**. Decrease in the prescribed prices has been made at 9.86% in each category of consumers, except fertilizer (feedstock) plant which is governed by separate policy. Comparison between existing sale prices and revised prescribed prices is attached at **Annexure-C**. The revised prescribed prices allowed by the Authority on provisional basis shall be subject to adjustment upon receipt of Federal Government advice under Section 8(3) of the Ordinance, in respect of the sale price of gas for each category of retail consumers provided that the overall decrease in the average prescribed price remains unchanged so that the petitioner is able to achieve its total revenue requirement in accordance with Section 8(6)(f) of the Ordinance.

(M. H. Asif)
Member (Finance)

(Rashid Farooq)
Member (Oil)

(Jawaid Inam)
Member (Gas) /
Vice Chairman

Islamabad,
September 27, 2006

Determination of Revised Revenue Requirement (RERR-1) Determined by Oil and Gas Regulatory Authority

Rs. in million

	Particulars	The Petition	Adjustment	Determined by OGRA
Gas sales volume -MMCF		**377,042**	**-**	**377,042**
	BBTU	**360,741**	**-**	**360,741**
"A"	**Net Operating Revenues**			
	Gross sales net of general sales tax	75,124	8,317	83,441
Less:	Gas development surcharge- existing	(6,965)	7,255	291
	Net sales at current prescribed price	83,151	-	83,150
	Meter rentals	502	(10)	491
	Late payment surcharge		301	301
	Amortization of deferred credit	187	-	187
	Sale of gas condensate	398	-	398
	Meter manufacturing profit		62	62
	Gas transportation charges	517	-	517
	Income from JJVL	2,203	262	2,465
	Other operating income	139	1	140
	Total Operating Revenue "A"	**87,098**	**616**	**87,712**
"B"	**Less: Operating Expenses**			
	Cost of gas	76,378	(8,339)	68,039
	Cut of UFG (in excess of OGRA benchmark)	-	(255)	(255)
	Transmission and distribution cost	4,908	(355)	4,553
	Gas internally consumed	258	(86)	173
	Depreciation	2,388	-	2,388
	Other charges including (W.P.P.F)	223	(65)	158
	Deferral account	360	-	360
	Total Operating Expenses "B"	**84,515**	**(9,099)**	**75,415**
"C"	**Operating profit (A-B)**	**2,583**	**9,715**	**12,297**
Return required on net operating fixed assets:				
Net operating fixed assets at beginning		22,963		22,963
Net operating fixed assets at ending		30,938		30,937
		53,901		53,900
Average net assets (I)		26,951		26,950
Deferred credit at beginning		2,000		2,000
Deferred credit at ending		2,160		2,160
		4,159	-	4,159
Average net deferred credit (II)		2,080	-	2,080
"D" Average (I-II)		**24,871**	(0)	**24,871**
"E" 17% return required		**4,228**	(0)	**4,228**
"F" Shortfall/(excess) in return required (C-E)		**1,645**	**9,715**	**(8,069)**
Increase (decrease) in average prescribed price (Rs. / MMBTU) (F/BBTUx1000)		**4.56**	**(26.93)**	**(22.37)**
Total estimated revenue requirement (B+E)		**88,743**	**(9,099)**	**79,643**

Revised Provisional Prescribed Prices for FY 2006-07, w.e.f. July 01, 2006, Determined by Oil and Gas Regulatory Authority

CATEGORY	Notified Prescribed Prices effective 01.07.06	Revised Prescribed Prices effective01.07.06
	Rs. per MMBTU	
(i) Domestic Consumers		
For domestic consumers, including residential colonies, mosques, churches, temples, madrassas, other religious places and hostels attached thereto, Government and semi-Government offices, hospitals, Government guest houses, Armed Forces messes and langars, universities, colleges, schools, private educational institutions, orphanages and other charitable institutions.		
First slab (upto 50 cubic metres per month).	85.03	76.63
Second slab (over 50 upto 100 cubic metres per month).	89.03	80.24
Third slab (over 100 upto 200 cubic metres per month).	162.07	146.06
Fourth slab (over 200 upto 300 cubic metres per month).	259.29	233.68
Fifth slab (over 300 cubic metres per month).	337.30	303.99
For hostels and residential colonies to whom gas is supplied through bulk meters.		
All off-takes at flat rate of	162.07	146.06
(ii) Commercial Consumers		
All establishments registered as commercial units with local authorities or dealing in consumer items for direct commercial sale like cafes, milk shops, tea stalls, canteens, barber shops, laundries, tandours, places of entertainment like cinemas, clubs, theaters and private offices, clinics, maternity himes etc.		
All off-takes at flat rate of	292.15	263.30
(iii) Ice Factories		
All off-takes at flat rate of	292.15	263.30
(iv) Industrial Consumers		
All consumers engaged in the processing of industrial raw material into value added finished products irrespective of the volume of gas consumed including hotel industry but excluding such industries for which a separate rate has been prescribed.		
All off-takes at flat rate of	264.54	238.42

(v)	**<u>Captive Power</u>**		
	All off-takes at flat rate of	264.54	238.42
(vi)	**<u>CNG Stations</u>**		
	All off-takes at flat rate of	264.54	238.42
(vii)	**<u>Cement Factories</u>**		
	All off-takes at flat rate of	264.54	238.42
(viii)	**<u>Pakistan Steel</u>**		
	All off-takes at flat rate of	264.54	238.42
(ix)	**<u>Fauji Fertilizer Bin Qasim Limited</u>**		
	(i) For gas used as feed stock for Fertilizer.	36.77	36.77
	(ii) For gas used as fuel for generating steam and electricity and for usage in housing colonies for fertilizer factories.	264.54	238.42
(x)	**<u>Power Stations</u>**		
	All off-takes at flat rate of	264.54	238.42

Comparison between Existing Sale Prices and Revised Prescribed Prices

Category	Existing Sale Prices effective 01.07.2006	Revised Prescribed price w.e.f. 01.07.06	Difference
	Rupees per MMBTU		
Domestic			
1st Slab	85.03	76.63	8.40
2nd Slab	89.03	80.24	8.79
3rd Slab	162.07	146.06	16.00
4th Slab	259.29	233.68	25.60
5th Slab	337.30	303.99	33.31
Commercial	298.03	263.30	34.73
General Industry	264.87	238.42	26.45
CNG	264.87	238.42	26.45
Captive Power	264.87	238.42	26.45
Pak Steel	264.87	238.42	26.45
Cement	305.15	238.42	66.73
Power	264.87	238.42	26.45
Fauji Fertilizer Bin Qasim Limited			
Feed-stock	36.77	36.77	-
Fuel	264.87	238.42	26.45

Computation of Revised Weighted Average Cost of Input Gas

FIELD	SNGPL		SSGCL		TOTAL		
	BBTU	Total Rs. in million	BBTU	Total Rs. in million	BBTU	Cost per MMBTU	Total Rs. in million
Sui	137,535	12,490	39,708	3,606	177,243	90.81	16,096
Dhodak	28,267	5,010			28,267	177.24	5,010
Dakhni	8,899	789			8,899	88.71	789
Loti	6,761	564			6,761	83.35	564
Sadkal	1,697	469			1,697	276.22	469
M. Kaswal	445	7			445	15.99	7
Qadirpur	184,823	30,042			184,823	162.55	30,042
Pirkoh	15,027	1,252			15,027	83.35	1,252
Adhi	14,323	1,269			14,323	88.62	1,269
Ratna	840	197			840	235.02	197
Bhangali	479	60			479	124.62	60
Dhurnal	441	3			441	7.89	3
Meyal	1,770	138			1,770	77.99	138
Dhulian	442	34			442	77.99	34
Pindori	12,356	2,573			12,356	208.24	2,573
Pariwali	8,218	1,711			8,218	208.24	1,711
Turkwal	-	-			-		-
Hasan	7,011	992	48	7	7,059	141.56	999
Sawan	95,925	18,598	46,050	8,928	141,975	193.88	27,526
Zamzama	58,255	10,652	27,893	5,096	86,148	182.81	15,749
Chanda	5,545	908			5,545	163.69	908
Rehmat / Mubarak	21,805	3,323			21,805	152.40	3,323
Badar	3,115	602			3,115	193.39	602
Kandkot	14,629	1,329	155	14	14,784	90.81	1,343
Gurguri / Ratana II	23,309	3,585			23,309	153.79	3,585
Badin			75,627	14,491	75,627	191.61	14,491
Daru			1,603	125	1,603	77.99	125
Kadanwari			22,528	10,026	22,528	445.04	10,026
Miano			42,611	8,261	42,611	193.88	8,261
Bhit			95,556	19,899	95,556	208.24	19,899
Mari			215	8	215	36.42	8
Ghotki Town - SNGPL			162	19	162	115.52	19
Rustam Town - SNGPL			36	4	36	115.52	4
Sari / Hundi			671	176	671	262.81	176
Mazarani			3,310	349	3,310	105.44	349
Khipro Block - Naimat Basal / Siraj			11,553	1,761	11,553	152.40	1,761
Radho	8,143	1,252			8,143	153.79	1,252
Chachak	8,534	1,312			8,534	153.79	1,312
Sinjhoro			3,709	570	3,709	153.79	570
Bhit II			6,104	1,271	6,104	208.24	1,271
Bobi			3,709	570	3,709	153.79	570
Mirpukhas Block - Kausar			16,758	2,554	16,758	152.40	2,554
Total Purchases	**668,594**	**99,164**	**398,006**	**77,736**	**1,066,600**	**165.85**	**176,900**
Add: CED		3,403		2,026		5.09	5,429
	668,594	**102,567**	**398,006**	**79,762**	**1,066,600**		**182,329**
Purification Charges		451		16			468
Total Input Cost of Gas	**668,594**	**103,018**	**398,006**	**79,779**	**1,066,600**	**171.38**	**182,797**
Weighted average cost of gas		**154.08**		**200.45**		**171.38**	