Case No. OGRA-6(2)-2(3)/2007-DTRR

IN THE MATTER OF

SUI SOUTHERN GAS COMPANY LIMITED
FINAL REVENUE REQUIREMENT, FY 2007-08

UNDER

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

DECISION

September 23, 2008

Before:

Rashid Farooq, Member (Oil) / Acting Chairman
M.H. Asif, Member (Finance)
Syed Hadi Hasnain, Member (Gas)

TABLE OF CONTENTS

SECTION **PAGE NO.**

ANNEXURES

TABLES

1. Background

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

1.2 The petitioner filed a petition (the petition) on August 19, 2008 under Section 8(2) of the Oil and Gas Regulatory Authority Ordinance, 2002 (the Ordinance) and Rule 4(3) of the Natural Gas Tariff Rules, 2002 (NGT Rules), for determination of its Final Revenue Requirement (FRR) for FY 2007-08 (the said year) on the basis of the accounts as initialed by its statutory auditors. The Authority admitted the petition on August 25, 2008.

1.3 The Authority, vide its Order dated January 03, 2008, had determined the petitioner's Second Revised Estimated Revenue Requirement for the said year (RERR-II) under Section 8(2) of the Ordinance at Rs. 92,733 million for estimated sale volume of 401,754 BBTU, and prescribed prices for various categories of consumers, on provisional basis, as shown in **Annexure-B**.

1.4 The petitioner has submitted the petition for determination of its FRR for the said year after incorporating the effect of actual changes in the wellhead gas prices, change in sales mix, other relevant factors in terms of Section 8(2) of the Ordinance and also has made some other claims. The petitioner has worked out its FRR for the said year at Rs. 81,346 million for actual sale volume of 351,733 BBTU. Based on the provisional prescribed prices and actual sale mix, the petitioner has computed a shortfall in its revenue requirement of Rs. 2,690 million for the said year, thereby seeking increase in the prescribed prices by Rs. 7.65 per MMBTU. The petitioner has also requested for an additional amount of Rs. 69 million on account of its Air-mix LPG Projects, increasing the shortfall to Rs. 2,759 million and average requested increase in prescribed price to Rs. 7.84 per MMBTU.

1.5 The Authority issued notice of hearing on August 26, 2008 to the petitioner and following interveners and related parties:

(i) Federal Government,

(ii) Karachi Chamber of Commerce & Industry, Karachi,

(iii) S.I.T.E. Association of Trade and Industry,

(iv) Mehmood Elahi Engineers, Sui Gas Contractors Punjab & Sarhad, Faisalabad,

(v) Aqeel Karim Dhedi Securities (Pvt.) Limited, Karachi,

(vi) All Pakistan CNG Association, Karachi.

(vii) Mr. Nessar Ahmed, Karachi,

(viii) Mr. Muhammad Arif Bilwani, Karachi,

(ix) Mr. Taufiq Habib, Karachi,

1.6 The hearing was held on September 15, 2008, at Islamabad.

2. Salient Features of the petition

2.1 The petitioner has submitted the following statement of cost of service per MMBTU:

Table 1: Comparison of Cost of Service per the petition with RERR-II & Previous Year

			Rs. per MMBTU
Particulars	**FY 2006-07**	**FY 2007-08**	
	FRR	**RERR-II**	**The Petition**
Units sold (BBTU)	**335,363**	**401,754**	**351,733**
Cost of gas sold	188.56	197.68	196.85
UFG adjustment per target	(3.45)	(0.76)	(2.19)
Transmission and distribution cost	13.77	14.26	17.96
Depreciation	6.52	6.72	6.20
Return on net average operating fixed assets	11.10	12.91	12.44
Other operating income	(16.61)	(12.60)	(10.30)
Subsidy for LPG Air Mix Project	-	-	0.20
Cost of service / prescribed price	**199.89**	**218.21**	**221.16**
Current average prescribed price	199.89	218.21	213.32
Increase requested in the average prescribed price	**-**	**-**	**7.84**

2.2 The petitioner has made the following submissions:-

2.2.1 The petitioner has claimed the required annual return, at Rs. 4,375 million, at the rate of 17% of the value of its average net operating fixed assets (net of deferred credit) before corporate income taxes, and interest, mark-up and other charges on debt, per license condition No. 5.2 and covenants of the loan agreement between the petitioner and the Asian Development Bank (ADB).

2.2.2 The petitioner has claimed a gross addition of Rs. 6,594 million in the fixed assets, and net addition, ex-depreciation and deletion, of Rs. 4,182 million, resulting in claimed increase in the net operating fixed assets from Rs. 27,082 million in FY 2006-07 to Rs. 31,264 million during the said year. The petitioner has further claimed that, after adjustment of deferred credits and assets related to Air-mix LPG Project, the net average operating fixed assets eligible for return work out to Rs. 25,738 million, and the required return to Rs. 4,375 million.

2.2.3 The net operating revenues have been claimed at Rs. 78,657 million in the petition, as against Rs. 92,733 million determined in RERR-II, as detailed below:

Table 2: Comparison of Operating Revenues per the petition with RERR-II & previous year

					Rs. in million
Description	**FY 2006-07**	**FY 2007-08**		**Increase / (Decrease) over RERR-II**	
	FRR	**RERR-II**	**The Petition**		
Net Sales at current prescribed price	67,037	87,670	75,033	(12,637)	-14%
Meter rentals	502	522	531	9	2%
Late payment surcharge	322	339	425	86	25%
Amortization of deferred credit	232	309	176	(133)	-43%
Sale of gas condensate	336	392	35	(357)	-91%
Meter manufacturing profit	121	120	66	(54)	-45%
Gas transportation charges	519	501	23	(478)	-95%
Income from JJVL	3,346	2,734	2,029	(705)	-26%
Other operating income	191	147	339	192	131%
Total:-	**72,606**	**92,733**	**78,657**	**(14,077)**	**-15%**

2.2.4 The net operating expenses have been claimed at Rs. 76,971 million in the petition as compared to Rs. 87,545 million provided in RERR-II, as detailed below:

Table 3: Comparison of Operating Expenses per the petition with RERR-II & previous year

					Rs. in million
Description	**FY 2006-07**	**FY 2007-08**		**Increase / (Decrease) over RERR-II**	
	FRR	**RERR-II**	**The Petition**		
Cost of gas	63,237	79,419	69,238	(10,181)	-13%
Transmission and Distribution costs	4,346	5,110	4,874	(236)	-5%
UFG disallowance above allowable limit	(1,154)	(306)	(769)	463	151%
Gas Internally Consumed (GIC)	105	141	120	(21)	-15%
Depreciation	2,186	2,701	2,182	(519)	-19%
Re-claimed items	51	292	240	(52)	-18%
Other Charges including WPPF	111	188	1,085	897	477%
Net Operating Expenses	**68,882**	**87,545**	**76,971**	**(9,649)**	**-11%**

2.2.5 The Unaccounted for Gas (UFG) has been claimed at 6.63% (27,093 MMCF) as against the upper and lower target of 6% and 5.10%, respectively, fixed by the Authority for the said year.

2.2.6 The net result of the petitioner's above mentioned claims is that a shortfall of Rs. 2,759 million has been computed including 17% return on average net operating fixed assets, which translates to an increase of Rs. 7.84 per MMBTU in the existing average prescribed price, as tabulated below:

Table 4: Computation of Average Increase in Prescribed Price per the Petition

	Particulars	**Rs. in million**
A	Net operating revenues	78,657
B	Less: Net operating expenses excluding ROA	76,971
	Subsidy LPG Air Mix Project	69
	Total Expenses	77,041
C	(Shortfall) / Surplus {(A) – (B)}	1,616
D	Return required @ 17% on net fixed assets in operation.	(4,375)
E	Total shortfall in the revenue requirement {(C) + (D)}	(2,759)
F	Sale volume (BBTU)	351,733
H	**Increase requested in the existing average prescribed price. Rs. / MMBTU (E/F*1000)**	**(7.84)**

3. Proceedings

3.1 The petitioner was represented at the hearing by a team of senior executives led by its Deputy Managing Director, Mr. Azim Iqbal Siddiqui, who were given full opportunity to present the petition. They made submissions in detail with the help of multimedia presentation. They also answered the questions raised by the members and officers of the Authority.

3.2 Mr. Jawad Gillani representing Mehmood Elahi Engineers, Sui Gas Contractors Punjab & Sarhad, Faisalabad and Mr. Imtiaz Haider on behalf of Aqeel Karim Dhedi Securities (Pvt.) Limited, Karachi were present in the hearing.

3.3 Mr. Jawad Gillani strongly opposed the inclusion of gas theft as part of admissible expenditure under the current pricing mechanism since it represented inefficiency of the petitioner. It was also stated that gas theft was only possible in collusion with the petitioner's staff.

3.4 Revision of slab-wise tariff structure was demanded on the basis of the universally accepted principle that tariff charged generally decreases with increase in consumption of any commodity, which is not the case in the existing slab-wise natural gas tariff structure where tariff increases with increase in consumption.

4. Determination

4.1 After detailed scrutiny of the petition, and clarifications given by the petitioner before, during and after the hearing, , the Authority determines as follows:

5. Return to Licensee

5.1 The Authority is obligated under Section 7(1) of the Ordinance, to determine or approve tariff for regulated activities whose licenses provide for such determination or such approval, or where authorized by this Ordinance, subject to policy guidelines. License Condition No. 5.2 of license granted to the petitioner, clearly states that the Authority shall determine total revenue requirement of the licensee to ensure that it achieves 17% return on its average net fixed assets in operation for each financial year, subject to the efficiency related benchmarks adjustments. The Authority, accordingly, has been determining the revenue requirement of the petitioner, providing the said return on net operating assets in accordance with the said provision of the Ordinance as well as the petitioner's license.

6. Operating Fixed Assets

6.1 Summary

6.1.1 The petitioner has claimed a gross addition of Rs. 6,594 million in the fixed assets, and net addition, ex-depreciation and deletion, of Rs. 4,182 million, resulting in claimed increase in the net operating fixed assets from Rs. 27,083 million in FY 2006-07 to Rs. 31,264 million during the said year. The petitioner has further claimed that, after adjustment of deferred credits and assets related to Air-mix LPG Project, the net average operating fixed assets eligible for return work out to Rs. 25,738 million, and the required return to Rs. 4,375 million, as tabulated below:

Table 5: Computation of Return on Assets per the petition

Particulars	Rs. in million
Net operating fixed assets at beginning	27,083
Net operating fixed assets at closing	31,264
Sub-total:	58,347
Average net assets (A)	***29,174***
Net Air-mix LPG Project assets at beginning	85
Net Air-mix LPG Project assets at closing	80
Sub-total:	165
Average net assets (B)	***83***
Net Deferred credit at beginning	2,977
Net Deferred credits at closing	3,730
Sub-total:	6,707
Average net deferred credit (C)	***3,353***
Average (A-B-C)	25,738
Return required on net operating fixed assets	17%
Amount of return requested by the petitioner	**4,375**

6.1.2 The petitioner has included a sum of Rs. 43 million (net of depreciation) on account of IT related assets, which was disallowed by the Authority in its determination of FRR FY 2006-07 dated September 14, 2007 subject to the provision of specific information in respect of IT. The petitioner has contended that it has provided the required information and since no further query has been received, it believes that the Authority is satisfied.

6.1.3 The Authority notes that the petitioner has not yet provided the specific information in quantitative terms which could enable assessment of the prudence of this expenditure. Further, the I.T project as a whole is currently under Authority's comprehensive review and decision on the same will be issued separately.

6.1.4 The petitioner has also included an amount of Rs. 26 million on account of depreciation on gas meters, which was disallowed by the Authority per its determination of FRR and motion for review of FRR FY 2005-06, on the ground that no convincing justification was provided for revision in rates and prior approval had not been obtained from the Authority and Federal Government for charging the higher rate of depreciation.

6.1.5 ***The Authority, therefore, maintains its earlier decisions in respect of IT related assets and depreciation on gas meters.***

6.1.6 ***Consequently, the Authority determines the opening balance of net operating fixed assets at Rs. 27,066 million.***

6.1.7 Comparative analysis of additions in fixed assets with the RERR-II and the previous year is as follows:

Table 6: Summarized Schedule of Additions Compared with RERR-II

				Rs. in million
Particulars	**FY 2007-08**		**Inc./(Dec.) over RERR-II**	
	RERR-II	**The Petition**		**%**
Land	64	11	(53)	-82%
Building	100	138	38	38%
Transmission line	1,328	370	(958)	-72%
Compressor	156	-	(156)	-100%
Plant & machinery	281	96	(185)	-66%
Gas distribution system	5,509	5,115	(394)	-7%
Road, pavements and related (ROW)	313	139	(174)	-56%
Furniture & fixtures	201	112	(89)	-44%
Computer software (Intangible)	40	55	15	37%
Appliances loose tools & equipment	24	17	(7)	-29%
Telecommunication system	13	12	(2)	-12%
Vehicles	227	233	6	3%
Construction equipment & vehicles	199	14	(185)	-93%
SCADA	30	283	253	835%
Total addition	**8,485**	**6,594**	**(1,891)**	**-22%**

6.1.8 The petitioner has explained that exorbitant increase on account of SCADA expenditure is due to revamp of telecom and expansion of SCADA system, which has already been approved by the Authority as part of GIREP-II.

6.2 IT Related Expenditure

6.2.1 The petitioner has incurred Rs. 165 million in respect of capital and revenue IT related expenditure for the said year. The amount has been booked by the petitioner under various heads, break-up of which is as under.

Table 7: Detail of IT Related Expenditure per the petition

Nature of Expenditure	Expenditure Type	Head of Account	Rs. in million
Capital	Computer and Ancillary Equipment	Furniture & Equipment	54
	Computer Software	Intangible Asset	55
		Sub-total:	*109*
Revenue	Software Licence & Dev. Charges	Legal & Prof. Charges	6
	Software Maint. Charges	Repair & Maintenance	34
	Computer Rep. & Maintenace	Repair & Maintenance	16
		Sub-total:	*57*
		Total	***165***

6.2.2 The petitioner has claimed Rs. 28 million under "computer software" and Rs. 4 million as part of "software maintenance charges" pertaining to GIS and ERP. The petitioner's I.T project as a whole, including GIS and ERP, is currently under Authority's comprehensive review and decision on the same will be issued separately.

6.2.3 ***The Authority, therefore, defers decision on computer software amounting to Rs. 28 million and Rs. 4 million software maintenance charges (under the head "Repair & Maintenance") on account of GIS and ERP and provisionally excludes these amounts from computation of Revenue Requirement for the said year.***

6.2.4 ***The Authority, in view of the above, allows IT - related expenditure at Rs. 133 million, as under:-***

Table 8: IT Related Expenditure Determined by the Authority

Particulars	Rs. in million
Capital Expenditure	
Computer and Ancillary Equipment	54
Computer Software	27
Revenue Expenditure	
Software Licence & Dev. Charges	6
Software Maint. Charges	30
Computer Rep. & Maintenace	16
Total	**133**

6.3 Fixed Assets Determined by the Authority

6.3.1 *The Authority, after due diligence and detailed examination of the submissions made by the petitioner, provisionally detennines the additions in fixed assets at Rs. 6,566 millionfor the said year.*

6.3.2 *Depreciation expense claimed by the petitioner would reduce by Rs. 4 million as a result of disallowance discussed in para 6.2.3 above and Rs. 21 million on account of depreciation relating to reclaimed IT related expenditure, in accordance with para 6.1.3 above.*

6.3.3 *After adjustment of depreciation per para 6.3.2 above, the closing net operating fixed assets for the said year are determined at Rs. 31,189 million, subject to adjustments, if any, based on findings of cost and procurement audit which may be instituted by the Authority.*

7. Operating Revenues

7.1 Sales Volume

7.1.1 Sales volume has decreased by 12.5%, from 401,754 BBTU determined in RERR-II to 351,733 BBTU in the petition. Category-wise comparison with previous year has been provided by the petitioner as under:

Table 9: Comparison of Category-wise gas Sales per the petition with RERR-II

Volume in BBTU

Category	FY 2006-07	FY 2007-08		Inc. / (Dec.) over RERR-II	
	FRR	RERR-II	The Petition		%
Power	123,040	159,302	116,900	(42,402)	-27%
Cement	3,249	6,012	3,255	(2,757)	-46%
Fertilizer-Feed	17,431	20,170	20,988	818	4%
CNG Stations	12,425	13,072	16,283	3,211	25%
Captive Power	35,927	46,387	40,477	(5,910)	-13%
General Industries	75,685	85,996	80,419	(5,577)	-6%
Commercial	8,414	8,834	9,642	808	9%
Domestic	59,193	61,981	63,770	1,789	3%
Total:-	**335,364**	**401,754**	**351,733**	**(50,021)**	**-12%**

7.1.2 The petitioner has stated that delay in operation of Nitrogen Rejection Unit at Zamzama-II and reduction in production of gas from Miano field are the primary factors contributing towards lower off-takes from these gas fields than envisaged. Further, delay in signing of GSA and pipeline contribution agreement with the producers in respect of Sinjhoro and Zarghun gas fields has also reduced the sales volume for the said year.

7.1.3 In addition to the above, the petitioner has informed that due to major shortfall of gas supply during winter in the country's northern region, about 3,520 MMCF was diverted to it on as and when required basis. The petitioner has also cited law and order situation in December, 2007, particularly virtual stoppage of all economic activities for three days throughout its area of operation as reasons for lower gas sales to industrial and commercial consumers.

7.1.4 ***The Authority accepts the total sales volume at 351,733 BBTU for the said year.***

7.2 Sales Revenue at Existing Prescribed Prices

7.2.1 Sales revenue at existing prescribed prices claimed in the petition is Rs. 74,981 million. Category-wise comparison with RERR-II and previous year is given below;

Table 10: Comparison of Category-Wise Sale Revenue per the petition with RERR-II

Rs. in million

Category	FY 2006-07 FRR	FY 2007-08 RERR-II	FY 2007-08 The Petition	Inc. / (Dec.) over RERR-II	%
Power	28,880	40,381	29,869	(10,512)	-26%
Cement	816	1,950	1,054	(896)	-46%
Fertilizer-Feed	641	742	772	30	4%
CNG Stations	2,977	3,651	4,544	893	24%
Captive Power	8,168	11,386	9,925	(1,461)	-13%
General Industries	16,318	19,834	18,585	(1,249)	-6%
Commercial	2,148	2,434	2,707	273	11%
Domestic	7,089	7,292	7,525	233	3%
Total:-	**67,036**	**87,670**	**74,981**	**(12,688)**	**-14%**

7.2.2 The Authority observes that reduction in sale revenue for the said year, as compared to RERR-II, is due to the reasons mentioned in para 7.1.2 above.

7.2.3 ***The Authority determines the sales revenue at Rs. 74,981 million for the said year.***

7.3 Other Operating Income

i. Summary

7.3.1 The petitioner has claimed other operating income at Rs. 3,624 million as against Rs. 5,063 million provided in RERR-II. Detailed breakup is compared below:

Table 11: Comparison of Other Operating Income per the petition with RERR-II and Previous Year

Rs. in million

Description	FY 2006-07 FRR	FY 2007-08 RERR-II	FY 2007-08 The Petition	Increase / (Decrease) over RERR-II	
Meter rentals	502	522	531	9	2%
Late payment surcharge	322	339	425	86	25%
Amortization of deferred credit	232	309	176	(133)	-43%
Sale of gas condensate	336	392	35	(357)	-91%
Meter manufacturing profit	121	120	66	(54)	-45%
Gas transportation charges	519	501	23	(478)	-95%
Income from JJVL	3,346	2,734	2,029	(705)	-26%
Other operating income	191	147	339	192	131%
Total:-	**5,569**	**5,063**	**3,624**	**(1,440)**	**-28%**

ii. Sale of Gas Condensate

7.3.2 The petitioner has claimed income from sale of gas condensate at Rs. 35 million as against Rs. 392 million determined in RERR-II.

7.3.3 The petitioner has submitted that regulated activities of transmission, distribution & sale of natural gas do not include sale of gas condensate and hence income derived therefrom should be treated as non-operating income while determining its revenue requirement in respect of regulated activities per its license. The petitioner has therefore, added Rs. 35 million on account of cost of gas, operating cost, gas internally consumed and depreciation pertaining to LHF plant at Badin in its operating income as against actual net income of Rs. 631 million from sale gas condensate.

7.3.4 The Authority notes that issue of sale of gas condensate was neither brought up by the petitioner at the time of submission of its petition for ERR for the said year nor in any review of ERR, hence the principal of estoppel is applicable. However, even, on merit, the petitioner's arguments hold no water. The Authority observes that the whole system of which extraction of condensate from LHF plant is an off-shoot, has been financed over the years through gas price mechanism. Similarly, depreciation, other operating expenses and return related to this plant have always been claimed by the petitioner as part of revenue requirement. The petitioner's latest stance defies logic.

7.3.5 ***In view of the above, the Authority disagrees with the petitioner's contention and, therefore, maintains treatment of sale of gas condensate as operating income and determines the same at Rs. 631 million for the said year.***

iii. Royalty from JJVL

7.3.6 The petitioner has requested that royalty from JJVL amounting to Rs. 2,145 million be treated as non-operating. The petitioner is of the view that the Authority has been declining the matter without considering the petitioner's view / justification. The petitioner has argued that it had the right to process LPG under its GSA with gas producer, prior to the commissioning of JJVL plant. As per the terms of agreement with JJVL, the royalty was payable to the petitioner from the target commissioning date of JJVL plant, irrespective of actual start of its commercial operations, and it will remain payable to it till the entire term of this agreement.

7.3.7 The petitioner is of the view that compensation amount is payable on account of reduction in calorific value of Composite Associated Gas Mixture (CAGM), while the royalty is payable against its right to process CAGM available at the facility. The very purpose of royalty is to provide incentive rather than to increase petitioner's profitability.

7.3.8 The Authority notes that the arguments advanced now by the petitioner are not new and mere repetition. The Authority has, time and again, reviewed and analysed the submissions of the petitioner in its various earlier decisions and, therefore, decision of the Authority to treat royalty from JJVL as operating income has reached finality.

7.3.9 ***In view of above, the Authority maintains its decision of treating royalty from JJVL amounting to Rs. 2,145 million, as operating income for the said year.***

iv. Meter Manufacturing Profit (MMP)

7.3.10 The petitioner has claimed MMP at Rs. 66 million showing a decrease of 45% over RERR-II. Trend analysis of MMP is given below:

Table 12: Comparison of MMP per the petition with RERR-II and Previous Years

Description	FY 2006-07	FY 2007-08		Inc. / (Dec.) over RERR-II	
	FRR	RERR-II	The Petition		%
MMP	121	120	66	(54)	-45%

7.3.11 The petitioner explained that SNGPL, the only regular purchaser of gas meters produced by it, had delayed the purchase order for meters and hence production of meters was comparatively reduced as against estimates in RERR-II. The petitioner added that cost of production has also increased resulting in lower profits during the said year.

7.3.12 ***In view of above, the Authority accepts MMP at Rs. 66 million for the said year.***

v. Gas Transportation Income

7.3.13 The petitioner has claimed Gas Transportation income at Rs. 23 million for the said year. The petitioner has explained that gas transportation income is recovered on the basis of contractual arrangements / pipeline rental agreements with OGDCL for the use of 40 Km segments from Paish Bogi to Pirkoh and with SNGPL for use of Bhit, Zamazama and Hassan gas pipeline. The petitioner has now recognized these rental arrangements as leases in terms of IFRIC-4. In accordance with the requirements of IFRIC-4, the pipelines have been recognized as net investment in finance leases and the related depreciation, operating cost and return have been reclassified and recorded as recoveries, in their respective heads. Based on above, net increase in lease rental amounting to Rs. 23 million has been recorded as gas transportation income as against total income of Rs. 558 million on this account for the said year.

7.3.14 ***The Authority accepts the gas transportation income at Rs. 23 million for the said year.***

vi. ***Other Income***

7.3.15 The petitioner has claimed other income for the said year at Rs. 339 million as against Rs. 147 million in RERR-II.

7.3.16 The Authority observes that increase in other income by 131% is mainly due to the inclusion of "Income from sale of net investment in finance lease", which was previously booked under "Gas Transportation Income" as explained in para 7.3.13 above.

7.3.17 ***In view of the above, the Authority accepts the other income at Rs. 339 million as claimed by the petitioner for the said year.***

7.3.18 ***Keeping in view the discussion from para 7.3.2 to 7.3.17 above, the Authority determines the total other operating income at Rs. 6,365 million for the said year as against Rs. 3,624 million claimed by the petitioner, as detailed below:***

Table 13: Summary of Other Operating Income Determined by the Authority

			Rs. in million
Description	**The Petition**	**Adjustment**	**Determined by the Authority**
Meter rentals	531		531
Late payment surcharge	425		425
Amortization of deferred credit	176		176
Sale of gas condensate	35	596	631
Meter manufacturing profit	66		66
Gas transportation charges	23		23
Income from JJVL	2,029	2,145	4,174
Other operating income	339		339
Total:-	**3,624**	**2,742**	**6,365**

8. Operating Expenses

8.1 Cost Of Gas

8.1.1 The cost of gas per petition is Rs. 69,238 million, compared with Rs. 79,419 million determined in RERR-II, lower by Rs. 10,181 million (13%).

8.1.2 The Authority had determined input cost of gas on the basis of combined weighted average cost of gas purchased by the petitioner and SNGPL at Rs. 181.04 per MMBTU as part of RERR-II in accordance with the agreement for equalization of cost of gas dated 22nd September, 2003, between these two companies. On the basis of their actual audited results, weighted average of input cost of gas for the said year works out at Rs. 179.99 per MMBTU as under:

Table 14: Weighted Average Cost of Input Gas

Company	**MMCF**	**BBTU**	**Rs in million**	**Rs. per MMBTU**
SSGCL	409,780	392,477	83,858	213.66
SNGPL	664,206	620,551	98,474	158.69
Total	**1,073,986**	**1,013,028**	**182,332**	**179.99**

8.1.3 The above decrease in weighted average cost of gas, compared to RERR-II, is due to relatively smaller proportion of off-takes from various fields enjoying relatively higher well-head prices under the respective contracts. Further, the working is now based on payments actually made by the petitioner and SNGPL for purchase of gas in accordance with well-head gas prices as notified by OGRA.

8.1.4 ***In view of the above, the Authority determines the cost of gas sold for the said year at Rs. 69,238 million.***

8.2 **Unaccounted for Gas (UFG)**

8.2.1 The petitioner has claimed Unaccounted for Gas (UFG) at 6.63% (27,093 MMSCF) for the said year, as follows:

Table 15: Comparison of Unaccounted for Gas per petition with RERR-II & Previous Year

Volumes in MMCF

Particulars	FY 2006-07	FY 2007-08	
	FRR	RERR-II	The Petition
Gas Purchases	386,118	452,964	408,484
Gas Sales	357,036	426,374	381,391
UFG	29,082	26,590	27,093
UFG %	7.53%	5.87%	6.63%

8.2.2 The Authority, in its RERR for FY 2005-06, had fixed the UFG upper & lower targets for the said year at 6% & 5.10% respectively, with the conditions that the petitioner would be entitled to retain the savings in the event of actual performance being better than the lower target, fully bear UFG above the upper target from its own profits and UFG between the lower & upper target be adjusted in the revenue requirement to the extent of 50% and the balance 50% be absorbed by the petitioner from its own profit.

8.2.3 ***In view of above, the Authority tentatively determines UFG volume at 27,093 MMCF i.e. 6.63% as claimed by the petitioner's, subject to adjustment on the basis of UFG audit which may be commissioned by the Authority.***

8.2.4 The Authority observes that the petitioner has erroneously calculated the UFG disallowance of Rs. 759 million at Rs. 179.21 per MMBTU instead of WACOG of

Rs. 179.99 per MMBTU for the said year.

8.2.5 ***The Authority, therefore, provisionally disallows UFG above the benchmark for the said year per its earlier decision mentioned above, which will reduce the operating expenditure by Rs. 762 million.***

8.3 Transmission & Distribution (T & D) Cost

i. *Summary*

8.3.1 The petitioner has claimed that the transmission and distribution cost has come down by 13% i.e. from Rs. 5,542 million provided in RERR-II to Rs. 4,994 million, as compared below:

Table 16: Comparison of T & D Cost per the petition with RERR & Previous Years

Rs. in million

Particulars	FY 2006-07	FY 2007-08		Inc./(Dec.) over RERR-II	
	FRR	RERR-II	The Petition	Rs.	%
Salaries, wages and benefits (HR cost)	2,992	3,504	3,551	47	1
Stores, spares and supplies consumed	446	422	377	(45)	(11)
Material used on consumers installations	123	75	26	(49)	(65)
Electricity	65	65	64	(1)	(1)
Rent, rate and taxes	53	67	61	(6)	(9)
Travelling	62	53	59	6	12
Insurance	65	74	59	(16)	(21)
Provision for doubtful debts	146	200	130	(71)	(35)
Postage and bill delivery by contractors	39	76	63	(13)	(17)
Repairs and maintenance	451	568	488	(81)	(14)
Legal and professional charges	107	92	147	55	59
Security expenses	162	176	224	48	27
License and tariff regulation fee to OGRA	44	59	44	(15)	(25)
Advertisement	41	41	38	(3)	(7)
Gas bill collection charges	124	134	127	(6)	(5)
Gas bills stubs processing charges	14	13	14	2	12
Provision for slow moving obsolete stores	-	-	5	5	100
Others	56	77	94	17	22
Sub-total expenses	**4,990**	**5,697**	**5,572**	**(125)**	**(2)**
Add: Project Cost					
Interstate Gas Company Limited (ISGSL)	86	311	97	(214)	(69)
Expenditure relating to LNG project	68	91	50	(41)	(45)
	5,143	**6,099**	**5,718**	**(380)**	**(7)**
Less: Recoveries / Allocations	921	697	712	15	2
Recoveries / Refund of services			188		
Provision for doubtful debts for live customers					
Net T&D exp. before gas internally consumed	**4,222**	**5,402**	**4,819**	**(583)**	**(14)**
Add: Gas internally consumed	105	141	120	(20)	(14)
Loss due to sabotage activity			55	55	
Total T&D expenditure	**4,328**	**5,542**	**4,994**	**(548)**	**(13)**

8.3.2 Various components of T & D cost are discussed in the following paragraphs:

ii. Human Resource (HR) Cost

8.3.3 The petitioner has claimed HR benchmark cost for the said year at Rs. 3,551 as against Rs. 3,504 million provided in RERR-II. The actual HR cost has been claimed at Rs. 3,480 million in its initialed accounts.

8.3.4 The Authority had fixed a benchmark for HR cost (including all costs for permanent, contractual and casual / temporary employees) taking the actual HR cost of FY 2004-05 as base figure and indexed to increase in number of consumers with 60% weightage, increase in network with 20% weightage, gas sales volume with 20% weightage and allowed inflation adjustment to the extent of 50% of CPI subject to the condition that if the actual HR cost is higher than the benchmark HR cost, 50% of the amount will be adjusted in the revenue requirement and the balance 50% shall be absorbed by the petitioner from its own profits.

8.3.5 ***The Authority, in view of the above, determines the HR benchmark cost at Rs. 3,551 million for the said year.***

iii. Repair & Maintenance

8.3.6 The petitioner has claimed Rs. 488 million on account of repair & maintenance, as against Rs. 568 million according to RERR-II, showing a decrease of 14%.

8.3.7 The petitioner has stated that reduction in repair and maintenance expense is mainly due to compressor over-hauling, which was projected as revenue expenditure at the time of RERR-II, and the same has been now claimed as "capital expenditure", resulting in 97% decrease on account of sub-head "Compression" for the said year.

8.3.8 ***The Authority, in accordance with the discussion and decision in para 6.2.3 above, disallows Rs. 4 million on account of software maintenance charges and determines the repair & maintenance expense at Rs. 484 million for the said year.***

iv. Legal & Professional Charges

8.3.9 The petitioner has claimed Rs. 147 million on account of legal & professional charges, as against Rs. 92 million determined in RERR-II, showing significant increase of 59%.

Historical comparison of legal & professional charges is given below:

Table 17: Comparison of Legal & Professional Charges per the petition with RERR-II & Previous Year

					Rs. in million
Category	**FY 2006-07**	**FY 2007-08**		**Inc. / (Dec.) over RERR-II**	
	FRR	**RERR-II**	**The Petition**		**%**
Legal	20	12	71	59	491%
Professional	57	21	39	18	86%
Meter Reading by Contractors	30	47	35	(13)	-27%
Collecting Agent Commission	1	12	2	(10)	-86%
Total:-	**108**	**92**	**147**	**55**	**59%**

8.3.10 The petitioner has submitted that out of Rs. 71 million legal expenses, Rs. 60 million has been incurred on account of ICC Arbitration in the matter of Habibullah Coastal Power Company (HCPC). The petitioner has also stated that professional fee of Rs. 12 million has been paid to M/s SGS for conducting Technical Audit in accordance with the Authority's directive. These expenses were not envisaged earlier for the said year.

8.3.11 ***In view of above, the Authority accepts Rs. 147 million on account of legal and professional charges for the said year.***

v. Security Expenses

8.3.12 The petitioner has claimed Rs. 224 million on account of Security expenses, as against Rs. 176 million per RERR-II, for the said year, showing significant increase of 27%.

8.3.13 The petitioner has explained that increase in security expenses is due to payment of Rs. 75 million, being its share in Federal Government's security cover fee. This amount has been deposited by the petitioner under the directive of Ministry of Petroleum & Natural Resources through its letter no. 3(11) IDF-2004-SW dated August 25, 2007.

8.3.14 ***The Authority, therefore, accepts the same and allows security expense at Rs. 224 million for the said year.***

vi. Remaining Items of T & D Cost

8.3.15 Remaining items of T & D cost which have not been discussed above are claimed at Rs. 1,365 million as against Rs. 1,759 million provided in RERR-II, as detailed below:

Table 18: Summary of Remaining T & D Expenses per the petition with RERR-II & Previous Year

Rs. in million

Particulars	FY 2006-07	FY 2007-08		Inc/(Dec.) over RERR-II	
	FRR	RERR-II	The Petition	Rs.	%
Stores, spares and supplies consumed	454	422	377	(45)	(11)
Material used on consumers installations	123	75	26	(49)	(65)
Electricity	65	65	64	(1)	(1)
Rent, rate and taxes	53	67	61	(6)	(9)
Travelling	62	53	59	6	12
Insurance	65	74	59	(16)	(21)
Provision for doubtful debts	147	200	130	(71)	(35)
Postage and bill delivery by contractors	39	76	63	(13)	(17)
License and tariff regulation fee to OGRA	44	59	44	(15)	(25)
Advertisement	41	41	38	(3)	(7)
Gas bill collection charges	124	134	127	(6)	(5)
Gas bills stubs processing charges	14	13	14	2	12
Provision for slow moving obsolete stores	31	-	5	5	100
Loss due to sabotage activity			55	55	100
Others	56	77	94	17	22
Interstate Gas Company Limited (ISGSL)	86	311	97	(214)	(69)
Expenditure relating to LNG project	68	91	50	(41)	(45)
	1,470	**1,759**	**1,365**	**(393)**	**(22)**

8.3.16 ***The Authority accepts the remaining items of T&D cost at Rs. 1,365 million.***

8.4 ***In view of the discussion in paras ii to vi of section 8.3 above, the Authority determines the operating cost for the said year at Rs. 4,990 million as against Rs. 4,994 million claimed by the petitioner, as follows:***

Table 19: Summary of T & D Cost Determined by the Authority

Rs. in million

Particulars	Requested by the Petitioner	Increase/ (decrease)	Determined by the Authority
Salaries, wages, and benefits (HR cost)	3,551		3,551
Repair & Maintenance	488	(4)	484
Legal and professional charges	147		147
Security expenses	224		224
Remaining Items of T & D Cost	1,365		1,365
Sub-total expenses	**5,774**		**5,770**
Less: Recoveries /Allocations/ Adjustment	900		900
Net T&D exp. before gas internally consun	**4,874**		**4,870**
Add: Gas internally consumed	120		120
Total T&D Expenditure	**4,994**	**(4)**	**4,990**

8.5 **Reclaimed Items**

8.5.1 The petitioner has reclaimed Rs. 240 million, for the said year, as detailed below:

Table 20: Details of Reclaimed Items per the petition

S. No.	Particulars	Rs. in million
	A) ITEMS ALLOWED BY THE AUTHORITY	
1	Return on ROW & Infrastructure (FY 2006-07)	14
2	Depreciation on above	9
3	Depreciation allowed on policy change (FY 2005-06)	176
4	Treatment of intangible assets of Rs. 23 million	
	- amortization for FY 2006-07	8
	- return for FY 2006-07	1
5	Gas consumed internally of 11 MMCF	2
	Sub-Total	**209**
	B) OTHER ITEMS	
6	IT related items reclaimed	53
7	WPPF impact on above items reclaimed	1
	Sub-Total	**54**
	Treatment of intangible assets of Rs. 23 million adjusted in T & D cost	(23)
	Total	**240**

8.5.2 The breakup of Rs. 53 million on account of IT related reclaimed items, as submitted by the petitioner, is given below:

Table 21: Breakup of IT related Reclaimed Items per the petition

Particulars	Rs. in million	
Depreciation on Assets:		
Computer & allied equipment of Rs. 41 M	14	
Software of Rs. 23 M	8	
		21
Return on IT related assets:		
Computer & allied equipment of Rs. 41 M	2	
Software of Rs. 23 M	1	
		4
IT related revenue cost		**28**
Total		**53**

8.5.3 The petitioner has claimed depreciation and return on capital expenditure of Rs. 64

million relating to computer and allied equipment and software (intangible assets) and Rs. 28 million against revenue expenditure, previously disallowed by the Authority. The petitioner is of the view that it has provided entire information as desired by the Authority and, therefore, re-claiming it as part of gas price.

8.5.4 ***The Authority has discussed this issue in para 6.1.3 above and therefore excludes Rs. 53 million from the re-claimed items.***

8.5.5 ***In view of above, the Authority, determines reclaimed items at Rs. 188 million for the said year.***

8.6 **Other Charges including Workers Profit Participation Funds (W.P.P.F)**

8.6.1 The petitioner has claimed Rs. 1,085 million including Rs. 276 million on account of W.P.P.F for the said year.

8.6.2 The petitioner has claimed Rs. 795 million on account of "Exchange loss on payment of gas purchases" under the head of "Other Charges". The petitioner has explained that volatile fluctuation in the currency market has resulted in exchange losses in respect of payment of gas.

8.6.3 ***Consequent upon the deduction / adjustments in the various components of revenue requirements as discussed above, W.P.P.F. is increased by Rs. 13 million for the said year.***

8.6.4 ***In view of the above discussion, the Authority's determines other charges including W.P.P.F at Rs. 1,098 million, for the said year.***

9. Decision

9.1 In view of the justifications submitted and arguments advanced by the petitioner in support of its petition, scrutiny by the Authority and detailed reasons recorded in earlier paras, the Authority recapitulates and decides to:

9.1.1 ***determine the addition in fixed assets at Rs. 6,566 million as against at Rs. 6,594 million claimed by the petitioner for the said year, consequently reducing the depreciation expense by Rs. 25 million;***

9.1.2 ***determine other operating income at Rs. 6,365 million as against Rs. 3,624 million per the petition;***

9.1.3 ***disallow Rs. 762 million, on account of UFG in excess of benchmarks fixed by the Authority;***

9.1.4 ***determine T&D cost at Rs. 4,990 as against Rs. 4,994 million per the petitioner;***

9.1.5 ***determine re-claimed items at Rs. 188 million as against Rs. 240 million per the petition;***

9.1.6 ***determine other charges at Rs. 1,098 million as against Rs. 1,085 million per the petition;***

9.2 *In exercise of the powers under Section 8(2) of the Ordinance, the Authority determines the final revenue requirement of the petitioner for the said year at Rs. 81,346 million as against petitioner's claim of Rs. 81,416 million, as tabulated below:*

Table 22: Components of FRR for the Said Year as Determined by the Authority

		Rs. in million
Final Revenue Requirement FY 2007-08	**Claimed by the Petitioner**	**Determined by the Authority**
Cost of gas	69,238	69,238
Disallowance on account of UFG	(769)	(762)
Transmission & distribution cost	4,874	4,870
Gas internally consumed	120	120
Depreciation	2,182	2,157
Prior Year Reclaimed Items	240	188
Other Charges including WPPF	1,085	1,098
Return on net operating fixed assets	4,375	4,368
Air-mix LPG Project	69	69
Final Revenue Requirement	**81,416**	**81,346**

9.3 *The petitioner's actual net operating income is Rs. 81,398 million and thus there is a surplus of Rs. 53 million, vis-à-vis its revenue requirement for the said year. To adjust this surplus, the Authority hereby adjusts the average prescribed prices downward by Rs. 0.15 per MMBTU (Annexure-A).* ***Revised prescribed prices for each category of retail consumers for FY 2007-08 are attached and marked Annexure-C.***

(Syed Hadi Hasnain)
Member (Gas)

(M.H. Asif)
Member (Finance)

(Rashid Farooq)
Member (Oil) /
Acting Chairman

Islamabad,
September 23, 2008

A. Final Revenue Requirement for FY 2007-08

Rs. in Million

	Particulars	The Petition	Adjustment	Determined by OGRA
Gas sales volume -MMCF		**377,265**		**377,265**
	BBTU	**351,733**		**351,733**
"A"	**Net Operating Revenues**			
	Gross sales net of general sales tax	74,995		**74,995**
Less:	Gas development surcharge- existing	(38)		**(38)**
	Net sales at current prescribed price	75,033		**75,033**
	Meter rentals	531		**531**
	Late payment surcharge	425		**425**
	Amortization of deferred credit	176		**176**
	Sale of gas condensate	35	596	**631**
	Meter manufacturing profit	66		**66**
	Gas transportation charges	23		**23**
	Revenue from JJVL	2,029		**2,029**
	Royalty income from JJVL		2,145	**2,145**
	Other operating income	339		**339**
	Total Operating Revenue "A"	**78,657**	**2,742**	**81,398**
"B"	**Less: Operating Expenses**			
	Cost of gas	69,238		**69,238**
	UFG Adjustment	(769)		**(762)**
	Transmission and distribution cost	4,874	(4)	**4,870**
	Gas internally consumed	120		**120**
	Depreciation	2,182	(25)	**2,157**
	Other charges including (W.P.P.F)	1,085	13	**1,098**
	Re-claimed items	240	(52)	**188**
	Total Operating Expenses "B"	76,971		**76,909**
"C"	**Operating profit (A-B)**	**1,686**	**(68)**	**4,490**
Return required on net operating fixed assets:				
Net operating fixed assets at beginning		27,083		**27,066**
Net operating fixed assets at ending		31,264	(75)	**31,189**
		58,347		**58,255**
Average net assets (I)		29,174		**29,128**
LPG Air Mix Project Assets				
Net assets at beginning		85		**85**
Net assets at ending		80		**80**
		165		165
Average net assets (II)		83		83
Deferred credit at beginning		2,977	-	**2,977**
Deferred credit at ending		3,730	-	**3,730**
		6,707		**6,707**
Average net deferred credit (II)		3,353		**3,353**
"D" Average (I-II)		25,738		**25,692**
"E" 17% return required		4,375	(8)	4,368
"F" (Shortfall) / Excess in return required (C-E) (Gas Operatio		(2,690)	2,812	122
"G"	**Project**	69	-	69
Total (Shortfall) / Excess (F+G)		(2,759)	2,812	53
(Increase) / Decrease in average prescribed price effective (Rs. / MMBTU)		**(7.84)**	**8.00**	**0.15**
Final revenue requirement (B+E+G)		**81,416**	**(70)**	**81,346**
Average Prescribed Price (Rs. per MMBTU)		**221.17**	**(8.00)**	**213.17**

B. Prescribed Prices per RERR-II FY 2007-08

CATEGORY		Prescribed Prices w.e.f July 01, 2007	Prescribed Prices w.e.f January 01, 2008
		Rs. per MMBTU	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)	78.38	78.38
	Second slab (over 50 upto 100 cubic metres per month)	82.07	82.07
	Third slab (over 100 upto 200 cubic metres per month)	149.40	149.40
	Fourth slab (over 200 upto 300 cubic metres per month)	239.01	239.01
	Fifth slab (All over 300 cubic metres per month)	310.92	310.92
	For hostels and residential colonies to whom gas is supplied through bulk meters.		
	All off-takes at flat rate of	149.40	149.40
(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 homes, etc.		
	All off-takes at flat rate of	267.96	283.05
(iii)	**Ice Factories:**		
	All off-takes at flat rate of	267.96	283.05
(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	238.30	251.55
(v)	**Captive Power:**		
	All off-takes at flat rate of	238.30	251.55

(vi)		**CNG Stations:**		
		All off-takes at flat rate of	**264.68**	**291.24**
(vii)		**Cement Factories:**		
		All off-takes at flat rate of	**304.75**	**335.67**
(viii)		**Pakistan Steel:**		
		All off-takes at flat rate of	**238.30**	**251.55**
(ix)		**Fauji Fertilizer Bin Qasim Limited:**		
	(a)	For gas used as feed stock for Fertilizer.		
		Commodity Charge		
		All off-takes at flat rate of	**36.77**	**36.77**
	(b)	For gas used as fuel for generating steam and electricity and for usage in housing colonies for fertilizer factories.		
		Commodity Charge		
		All off-takes at flat rate of	**238.30**	**251.55**
(x)		**Power Stations:**		
		All off-takes at flat rate of	**238.30**	**251.55**

C. Prescribed Prices Determined by the Authority for FY 2007-08

		Prescribed Prices	
		w.e.f July 01, 2007	w.e.f January 01, 2008
		Rs. per MMBTU	
CATEGORY			
(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)	78.21	78.21
	Second slab (over 50 upto 100 cubic metres per month)	81.90	81.90
	Third slab (over 100 upto 200 cubic metres per month)	149.23	149.23
	Fourth slab (over 200 upto 300 cubic metres per month)	238.84	238.84
	Fifth slab (All over 300 cubic metres per month)	310.75	310.75
	For hostels and residential colonies to whom gas is supplied through bulk meters.		
	All off-takes at flat rate of	149.23	149.23
(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, theatres and private offices, clinics, maternity homes etc.		
	All off-takes at flat rate of	267.79	282.88
(iii)	**Ice Factories:**		
	All off-takes at flat rate of	267.79	282.88
(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	238.13	251.38
(v)	**Captive Power:**		
	All off-takes at flat rate of	238.13	251.38

(vi)		**CNG Stations:**		
		All off-takes at flat rate of	**264.51**	**291.07**
(vii)		**Cement Factories:**		
		All off-takes at flat rate of	**304.58**	**335.50**
(viii)		**Pakistan Steel:**		
		All off-takes at flat rate of	**238.13**	**251.38**
(ix)		**Fauji Fertilizer Bin Qasim Limited:**		
	(a)	For gas used as feed stock for Fertilizer.		
		Commodity Charge		
		All off-takes at flat rate of	**36.77**	**36.77**
	(b)	For gas used as fuel for generating steam and electricity and for usage in housing colonies for fertilizer factories.		
		Commodity Charge		
		All off-takes at flat rate of	**238.13**	**251.38**
(x)		**Power Stations:**		
		All off-takes at flat rate of	**238.13**	**251.38**