Case No. OGRA-6(2)-2(2)/2008-Review

IN THE MATTER OF
SUI SOUTHERN GAS COMPANY LIMITED -
REVIEW OF ESTIMATED REVENUE REQUIREMENT,
FY 2008-09

UNDER

SECTION 8(2) OF OIL AND GAS REGULATORY AUTHORITY ORDINANCE, 2002 AND NATURAL GAS TARIFF RULES, 2002

DECISION

November 20, 2008

Before:

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

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1. BACKGROUND

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

1.2. The Authority had determined the Estimated Revenue Requirement (ERR) of the petitioner for FY 2008-09 (the said year) at Rs. 114,768 million vide its order dated May 20, 2008, under Section 8(1) of the Oil and Gas Regulatory Authority Ordinance, 2002 (the Ordinance).

2. PETITION

2.1. The petitioner has submitted this review petition (the petition) on October 17, 2008, under Section 8 (2) of the Ordinance, incorporating in the ERR, the effect of change in the projected Weighted Average Cost of Gas (WACOG) for the said year taking into account the latest actual oil prices in the international market, devaluation of rupee against US $, revised projection of gas purchase volume based on actual gas availability (purchases) for the months of July and August, 2008 and latest indications. The petitioner has also requested to include in the ERR a sum of Rs. 578 million being revenue expenditure incurred by Interstate Gas Systems (Pvt) Limited. (ISGSL), which was disallowed by the Authority. Further, the petitioner has revised its estimated operating income arising from gas transportation charges, sale of gas condensate and processing of gas by M/s Jamshoro Joint Venture Ltd. (JJVL), considering the impact of change in Pak rupee / US $ parity. The petitioner has projected a shortfall in ERR of Rs. 22,262 million and has sought immediate relief pursuant to Rule 5(7) of Natural Gas Tariff Rules, 2002 (NGT Rules, 2002).

2.2. The petitioner has projected the WACOG for the said year to rise to Rs. 296.08 per MMBTU as against Rs. 243.75 per MMBTU, provisionally determined by the Authority under its order dated May 20, 2008. This situation is claimed to have arisen mainly due the sharp increase of 18% in Pak rupee / US $ parity, from approximately Rs. 68 in June, 2008 to Rs. 82 in October, 2008. The prices of crude oil and High Sulphur Fuel Oil (HSFO) have also been sharply rising during June to September, 2008, four of the six months applicable for determining the well-head prices during second half of the said year in terms of Gas Pricing Agreements (GPAs) between the Government of Pakistan (GoP) and various gas producers.

2.3. The petitioner has sought immediate relief to cover the aforesaid estimated shortfall of Rs. 22,262 million during the said year, through increase in average prescribed price by Rs. 97.73 per MMBTU, effective December 01, 2008, (Rs. 58.39 per MMBTU on annualized basis), as sale prices could not possibly be increased on retroactive basis.

2.4. The petitioner has given component-wise breakup of requested increase in average prescribed price as under:-

Table 1: **Component-wise Breakup of Requested Increase in Average Prescribed Price**

			Rs./MMBTU
	Decrease in revenues due to revised sales volume and sales mix	(3.19)	
	Increase in revenues as a consequence of increased US$ exchange rate	3.07	
A	***Total Decrease in Revenues***		(0.12)
	Increase in Cost of Gas Sold		
	Increase in WACOG	52.63	
	Increase due to revised purchase volumes and inter company adjustment	3.54	
B	***Total Increase in Cost of Gas Sold***		56.17
C	*Consequential Increase in GIC & T & D Cost (ISGSL)*		2.10
D=(B+C)	**Total Increase in Expenditure**		58.27
D-A	**Net Increase effective July 01, 2008**		**58.39**
	Net Increase effective December 01, 2008		**97.73**

2.5. The Authority admitted the petition for consideration, as a prima facie case for evaluation existed and it was otherwise in order.

3. PROCEEDINGS

3.1. A notice inviting interventions / comments from the consumers, general public and other interested / affected persons, and intimating the time and place of the public hearing, was published in daily newspapers, namely: Business Recorder (combined), Jang (combined), Mashriq (Quetta) and Express (Karachi) on October 24, 2008. The Authority received applications to intervene in the proceedings from the following persons / entities:

(i) The All Pakistan Textile Mills Association, through Rashid Law Associates, Lahore.

(ii) The All Pakistan CNG Association.

(iii) M/s Aqeel Karim Dhedhi Securities (Pvt) Ltd., Karcahi.

(iv) Mr. Muhammad Arif Bilwani, Karachi.

3.2. Written submissions were also received from some of the interveners, which are appended to this order.

3.3. The Authority admitted all the above intervention requests.

3.4. The Authority held public hearing at Karachi on November 10, 2008. The following persons addressed the Authority:

(i) SSGCL's team led by Mr. Azim Iqbal Siddiqui, Deputy Managing Director, the petitioner.

(ii) Mr. Zubair Motiwala, representing Karachi Chamber of Commerce and Industry.

(iii) Mr. Nisar Shehkhani, Chairman, SITE Association of Industry, Karachi.

(iv) Mr. Iqbal Xaidi, Special Secretary Finance, Government of Sindh.

(v) Mr. Muhammad Arif Balwani of Karachi, an industrial and domestic consumer.

(vi) Mr. Imtiaz Haider, Group Head, representing M/s AKD Securities (Pvt.) Ltd., Karachi.

(vii) Mr. Ghulam Ali Pasha, Additional Chief Secretary Finance, Government of Sindh, Karachi.

3.5. First, the petitioner made submissions in detail with the help of multimedia presentation explaining the rationale of the petition. Thereafter, the above interveners and other participants addressed the Authority.

4. INTERVENERS' / PARTICIPANTS' VIEWS

4.1. The substantive points made by the interveners / participants are summarized below:

(a) General Comments

(i) The present constitution of the Authority is illegal for the purposes of conducting public hearing and deciding the instant petition. In the absence of a permanent chairman, no such hearing could lawfully be conducted as a vice chairman can only substitute if a serving chairman is not in a position to chair the meeting. An acting chairman could work only for a statutory period of three months from the date of occurrence of the chairman's vacancy. The hearing should, therefore, be deferred till the full time permanent chairman is appointed.

(ii) The petitioner has not provided any nomination or competent authorization in favour of the presenter of the petition, which requires that the petition be dismissed as having been filed incompetently and without authorization.

(iii) For a number of previous years, the Authority deems to have fulfilled its liability as a regulator by stating that it has already finalized its recommendations on new tariff regime, which are under Federal Government's review, and till finalization of the new tariff regime, it is obligated to follow the previous basis of rate of return on assets. The previous regime of guaranteed return of 17% on fixed assets has resulted in gold platting of assets. The Authority seems to have not pursued the case and is simply acting as postman. The consumer must not be allowed to wait and burdened for unlimited period of time due to inaction of the Federal Government. The Authority must now act on its own to safeguard the interest of consumers.

(iv) As the petitioner's loan agreement with Asian Development Bank (ADB) has expired, the guaranteed return should be abolished or rationalized.

(v) Failure of economic and monetary policies of the GoP has instigated the price increase sought by the petitioner. The consumer must not, therefore, be penalized for the negligence, apathy, lethargy and loathsome attitude of the GoP, which could not formulate such policies that could have mitigated the consequences of geo-political situation resulting in depreciation of rupee value. State Bank of Pakistan (SBP), on behalf of GoP, should provide exchange risk cover to gas utility companies so that this risk is borne by GoP instead of consumers.

(vi) GoP, through its wholly owned company, namely Government Holding (Pvt) Ltd., is a shareholder in most of the Exploration & Production (E & P) joint ventures and is earning huge windfall revenues from the same. In case of Oil and Gas Development Company Limited and Pakistan Petroleum Limited, GoP is the majority shareholder. These companies have huge financial reserves and do not need price increases. GoP also collects revenue at various stages as royalty, excise duty, taxes, GDS, etc., which is mounting on yearly basis. Thus GoP is a major beneficiary of increases in gas prices, at the cost of general consumers, and that is against the rationale and spirit of the law and policy. Therefore, GoP should not be facilitated through this price determination to enjoy windfall gains. GoP should relinquish its share of windfall gains arising from increased oil prices and exchange rate, and protect the gas consumers against the projected increase in price.

(vii) GoP has failed to re-negotiate the well-head price discounts in respect of Qadirpur gas field, owned primarily by public sector companies, despite lapse of almost two years even though it was required to do so within 6 months of the HSFO price going beyond US $ 200 / ton. OGRA should, therefore, not only intervene in the matter but should also penalize the concerned quarters for not taking timely and prudent decisions in the interest of public at large and allowing the gas producers to make windfall profits by supplying gas at extraordinarily high rates, resulting in sharp increase in cost of gas.

(viii) The petitioner has computed WACOG based on Qadirpur well-head gas price of Rs. 357 / MMBTU, which has not been notified by the Authority. The impact of Qadirpur price on WACOG is very high and the petitioner should, therefore, revise the price in accordance with the actual payments being made by it in accordance with the OGRA notification in the field.

(ix) The price of gas from Kadanwari field is 10 times the price of gas from Sui field, due to lacunae in gas well-head pricing formula. The Authority must intervene in public interest and reduce the well-head gas prices to provide relief to consumers at large.

(x) The well-head pricing formula and petroleum policy must be immediately reviewed to bring down the cost to bearable level. The linkage of indigenous gas price with international oil price is irrational and unjustified. GPAs, which are the basic relevant documents, are not publicly accessible and therefore consumers cannot comment on the same. The current well-head price mechanism is resulting in windfall gains for gas exploration companies as there is no increase in their cost structure, their fields having been in production for quite some time. Only the new fields should be allowed to avail the benefit of higher price, if at all.

(xi) A misconception is prevailing in OGRA to the effect that it is barred from examining the GPAs and has to accept the price mechanism as agreed in the GPAs. OGRA is an independent and autonomous body and without having realistic and critical appraisal of GPA's, it cannot reach a realistic decision. GoP and the petitioner must surrender the GPAs to the jurisdiction of OGRA for its critical analysis and scrutiny, which could thereafter determine the prices of the petitioner.

(xii) The well-head prices are always estimated on the higher side and a positive approach of projecting decrease in prices is not adopted. The petitioner should rework the WACOG computations based on the prevailing declining trend of oil prices. Further, the value of US dollar has started declining against rupee, owing to certain actions by the Government and this trend is likely to continue. Therefore, the US $ vis-à-vis rupee parity must be taken at reasonable level.

(xiii) Natural gas prices of all categories of consumers were increased by the Federal Government by 31% from July 01, 2008. Independent Power Projects were spared, depicting discriminatory and unfair approach.

(xiv) The average calorific value of the petitioner is 960 per MMCF as disclosed in table C-8 of the petition, however it has based its tariff computations at an average value of 948 per MMCF. The sister utility (SNGPL) on the other hand, is using its average calorific value (i.e; 937 per MMCF) for revenue requirement computations. This deviation needs to be investigated and corrected.

(xv) OGRA is an independent body under the OGRA Ordinance, empowered to make unbiased decisions in respect of determination of revenue requirements of gas utilities and resolution of consumer complaints, after providing opportunity of hearing to the respective stakeholders. However, it appears that the public hearings are held as a formality and the objections of the interveners and participants are not given due consideration by the Authority and the Federal Government. The Federal Government, in particular, has disregarded the comments and views of the consumers on policy issues for the past many years, which has caused public distress, disappointment and annoyance. For this reason, the public participation in these hearings is declining. (*Almost all participants expressed this view with a great deal of emotion and protested against the GoP's non-responsive and public unfriendly attitude*).

(xvi) Private financial consultants and auditors be appointed to scrutinize all projected financial and related details provided by the petitioner, so that realistic determination can be made.

(xvii) The petitioner should adopt simplicity and cut privileges and perks of the executives and other staff to meet the shortfall, instead of seeking further increase in gas price.

(xviii) The petitioner should take effective measures to recover its dues from defaulting consumers as substantial amount is blocked on account of doubtful debts.

(xix) UFG allowance contributes towards rise of gas rates, which needs to be reviewed. UFG is due to negligence of the company and its inefficiency must not be passed on to the consumers; rather the burden should be borne by the petitioner itself.

(b) Industrial Consumers - specific comments

(i) Cross-subsidizing fertilizer feed-stock and domestic sector at the cost of other categories of consumers is highly objectionable. Cross-subsidy is unconstitutional as one class of consumers can not be made to pay for a service more than the actual cost to facilitate another class to pay less than the actual cost. Supply of gas to fertilizer feed-stock at highly subsidized rates must be done away with as benefit of the same is not being passed on to the farmers, which is proven by the fact that the profits of the fertilizer companies are burgeoning. This is happening because their profits are not capped, checked and regulated by the Government. If the Government wishes to subsidize any sector, the correct approach would be to do so through budgetary support as in the case of electricity, instead of the prevalent cross-subsidy mechanism.

(ii) Evaluation criteria for tariff applications has been clearly stipulated under Rule 7 of the NGT Rules, 2002. The tariffs are required to be cost effective; however fertilizer and domestic sector are being subsidized and hence the tariffs are not cost effective for other categories of consumers.

(iii) The policies of the Federal Government have brought the industry at the verge of collapse and have created all kinds of economic distortions in the country.

(iv) The industry is already facing declining sales due to very stiff competition and growing global recession. Any further increase in gas tariff will simply push it out of the world market completely, precipitating to its closure, seriously compromising the country's exports, foreign exchange earnings, employment, income levels, in short, the whole economy. That will intensify the recessionary cycle, spread poverty, increase crime and God forbid, breakdown of the entire system.

(v) Being bulk users, rates for industry are, normally, much lower than the domestic rates all over the world, whereas the situation is just the opposite in Pakistan, impeding industrial development. Cost of doing business in Pakistan is already very high compared to its competitors like Bangladesh and India, where cost of production is kept low by the Governments through various measures. In Bangladesh, special reduced tariff is offered to export oriented industry, enabling it to have higher textile exports compared with Pakistan, even though it does not grow cotton. This structural anomaly should be corrected in the larger interest of the country.

(vi) On the pattern of CNG industry, the Federal Government should declare textile industry as a distinct category of consumers with fixed predictable tariff at a lower level, to help revive the large number of sick units, and preventing the remaining industry from getting sick.

(c) Shareholders - specific comments

(i) The current unfair treatment of some revenue items viz royalty from JJVL, meter manufacturing profit (MMP), late payment surcharge (LPS) and income from sale of gas condensate directly erodes the value of shareholder's investment. The petitioner, as well as the minority shareholders, have repeatedly requested for exclusion of the said incomes from fixed return formula. However, the pleas have consistently been rebuffed without adequate grounds. It was requested that the matter be given due consideration and reviewed by the Authority, within the ambit of the petitioner's license and scope of regulated activities, in order to fairly and adequately safeguard the interest of minority shareholders.

(ii) The definition of natural gas provided in the Ordinance does not merit inclusion of gas condensate; rather condensate can be classified as oil per the provisions of the Ordinance, and therefore, income derived from it should not be made part of the operating income of the petitioner.

(iii) The policies / directives of GoP should be implemented only if the related expenditure (capital and revenue) is provided by GoP itself. The strategy of GoP to provide gas to far flung unfeasible areas and villages by burdening other categories of consumers, mainly industrial, is neither fair nor prudent. GoP should formulate its socio-economic policies such that higher consumer prices and unacceptably low shareholder returns are not the end result, accentuating inflation and hurting investment climate.

(d) Government of Sindh - specific comments

(i) Government of Sindh's representative argued that GoP / OGRA should ensure that increase in prescribed gas prices does not decrease the Gas Development Surcharge (GDS) because that will reduce the share of provinces in federal revenues and consequent curtailment of development programmes of the provincial governments.

5. AUTHORITY'S JURISDICTION, DETERMINATION PROCESS AND DISCUSSION ABOUT RELATED POINTS

5.1. OGRA is a statutory body, established to regulate midstream and downstream oil and gas sector to the extent and in the manner stipulated in the OGRA Ordinance. OGRA discharges its responsibilities prudently and diligently accordingly. The suggestions or insinuations to the contrary by some of the participants in the hearing are without any basis, emanating from lack of understanding of the law or the Authority's decisions.

5.2. The objection taken about the legality of the present composition / constitution of the Authority is misconceived. A plain reading of Sections 2(ii), 4(1) and 4(4) of the OGRA Ordinance, leave no doubt about the legality of the instant proceedings.

5.3. The Authority examines, in depth, all applications and petitions in light of relevant legal provisions. The petitions / applications are admitted for consideration, only if they meet the pre-admission criteria laid in the NGT Rules, 2002. In the instant case, the petition has been filed by a duly authorized officer. In the process, public notices are issued and all the stakeholders are provided full opportunity to intervene / comment upon the issues pertaining to determination of revenue requirement, in writing and at public hearings. The Authority gives full consideration to observations and comments of all stakeholders while determining revenue requirement and prescribed prices. As regards policy matters, since Federal Government is the legally competent authority, the policy-related pleas, reservations and sentiments of the stakeholders are brought to its specific attention for consideration before deciding the retail prices for various categories of consumers.

5.4. GoP regulates the upstream oil & gas sector and Section 43A of the Ordinance specifically excludes those activities from the purview of OGRA. Over the years, it is the GoP that has been negotiating and concluding agreements with the E & P companies, which cover the parameters for determination of well-head gas price in accordance with the respective petroleum policies. OGRA has but a rather limited role in this matter. Pursuant to Section 6(2)(w) of the Ordinance, OGRA **determines and notifies "the well-head gas prices for the producers of natural gas in accordance with the relevant agreements or contracts"**. Therefore, some intervener's plea that the Authority should sit on judgment in these matters has no legal basis. OGRA is neither responsible nor legally competent to do any such thing.

5.5. The Authority under the ***License Conditions*** of the license, granted to the petitioner, determines total revenue requirement of the licensee to ensure that it operates prudently and achieves 17% return on its average net fixed assets in operation for each financial year, subject to efficiency related benchmarks, imposed from time to time. ***The Authority, may, however, in consultation with Federal Government (GoP)*** and the licensee prescribe revised rate of return or a different basis for determination of a return, pursuant to ***License Condition No. 5.3*** of the license granted to the petitioner. The Authority has developed a new tariff regime for regulated natural gas sector of Pakistan, which, in the course of legally mandatory consultation process, is with GoP. Pending its finalization, the Authority has decided to follow the existing basis of 17% return on the average net operating fixed assets, in accordance with the License Condition No. 5.2. The Authority, as elaborated in earlier decisions, does not subscribe to the view of some interveners that it should proceed to finalize the matter without having the benefit of GoP's views because GoP is an important stakeholder.

5.6. The instant petition is primarily focused on review of cost of gas / WACOG of the petitioner based on actual changes in the well-head gas prices and relevant factors. The well-head gas prices for the said year are based on the actual prices of crude oil and HSFO during the period December, 2007 to November, 2008. The declining trend in recent months is to be taken into account, along with persistent rise in prices in the previous months, while determining the WACOG to ensure that the determination is rational and fair to all stakeholders.

5.7. The operating revenues, operating expenses and changes in asset base are scrutinized by the Authority in depth. Appropriate benchmarks are set in critical areas of operation to ensure that the cost of petitioner's inefficiencies and imprudence are not passed on to the consumers. Independent audits are also conducted, wherever deemed necessary by the Authority. But for such controls, the operating expenses of the licensee would have been much higher than what they are and so would have been gas prices.

6. COST OF GAS

6.1. Petitioner's Grounds for Review

6.1.1. The petitioner has submitted that as against Rs. 243.75 per MMBTU, projected at the time of determination of ERR for the said year, the WACOG is projected to increase to Rs. 296.08 per MMBTU on an annualized basis, using the following parameters:

(i) Well-head gas prices of various producing fields for the period July 1, 2008 to December 31, 2008, as already notified by the Authority.

(ii) The prices of crude oil / HSFO during the period June, 2008 to November, 2008 to form the basis for computing well-head prices for the period January 1, 2009 to June 30, 2009 in accordance with the provisions of the existing GPAs between the producers and GoP.

(iii) Actual prices of crude oil and HSFO for the period June, 2008 to September, 2008 and at assumed price of US $ 70.98 per barrel and US $ 411.83 per metric ton respectively for October and November, 2008.

(iv) US $ exchange rate assumed at Rs. 82 w.e.f January 01, 2009 for calculation of well-head gas prices for the period January – June, 2009. However, US $ exchange rate for monthly invoicing to the gas producers assumed at an average rate of Rs. 83.17 for the said year.

6.1.2. On the basis of the above parameters, the petitioner has estimated average C & F prices of crude oil and HSFO for June-November, 2008 at US $ 103.59 per barrel and US $567.49 per ton respectively, and has used them for computation of well-head prices for January -June 2009.

6.2. Discussion & Decision

6.2.1. OGRA determines and notifies the well-head prices of gas for all fields in Pakistan in accordance with GPAs, which are available on record, in exercise of the powers vested in it under Section 6(2)(w) of the Ordinance. At the time of DERR on May 20, 2008, estimated WACOG 2008-09 was computed on the basis of estimated well-head gas prices which, in turn, were based on international oil prices that were projected taking the price trends, then prevailing, into account.

6.2.2. The Authority notes and some interveners have also pointed out that the petitioner has computed well-head gas price for Qadirpur field on the basis of actual average HSFO price of US $ 502.66 per ton during December, 2007 to May, 2008 for July-December, 2008, and estimated price of June to November, 2008 of US $ 567.84 per ton for January-June, 2009. As against these high prices, the maximum price given in the provisional discount table advised by GoP in July, 2006 was US $ 310/ ton. The last notification determining well-head gas price of Rs. 161.02 per MMBTU, issued by the Authority effective July, 2007 continues to be operative pending resolution between the producer and GoP and the petitioner is making payments for the gas purchases accordingly. Therefore, adopting any other estimated price for the present, is not justified. The Authority, therefore, provisionally adopts the said well-head price of Rs. 161.02 per MMBTU for Qadirpur gas.

6.2.3. The Authority also observes that the increasing trend of prices of crude oil and HSFO in the international market has taken an about turn recently and the prices are now sharply decreasing. These dropped to US $ 47.17 per BBL and US $ 212.97 per ton respectively as of November 17, 2008. The Authority provisionally adopts these low prices for the entire month of November, 2008.

6.2.4. Based on the above, average C&F prices of crude oil and HSFO for the period June-November, 2008 works out to US $ 99.0784 per BBL and US

$ 529.3124 per ton (**Annexure -IV**) as against petitioner's projections of crude oil at US $ 103.59 per barrel and HSFO at US $ 567.49 per ton.

6.2.5. The Authority notes that US $ exchange rate projected by the petitioner at Rs. 82 on January 01, 2009 and for payment of invoices of foreign gas producers at an average of Rs. 83.17 are high taking into account the fact that the trend of devaluation of Pak Rupee against US dollar has reversed in the recent weeks owing to bail out package offered by multi-lateral organizations as well as certain steps taken by the Government, and this slide is likely to continue. The Authority, therefore, is of the view that the worst is over and situation is expected to improve. Therefore, provisionally projects Pak Rupee / US dollar parity at Rs. 75 on January 01, 2009 and also for the purpose of monthly payments to the foreign gas producers during January – June, 2009.

6.2.6. The Authority finds that, on the basis of currently available information, the revised projections of sale and purchase volume submitted by the petitioner are reasonable. Some interveners have stated that the average calorific value used by the petitioner, of 948 per MMCF is not correct. The Authority has examined the matter and finds that after adjusting the gas shrinkage at JJVL plant at Jamshoro, the average calorific value of the petitioner comes to 950 per MMCF, and the petitioner has computed its volume projections accordingly. However, inadvertently on the tariff calculation sheet (table no. C-1 of the petition) 948 per MMCF is incorrectly mentioned. It is for this reason that the suspicion of adoption of nation-wide average calorific value of 948 per MMCF arose, which, in any case, is not factually correct.

6.2.7. Accordingly, estimated WACOG is computed at the reduced level of Rs. 251.73 per MMBTU (on annualized basis) as against Rs. 296.08 per MMBTU claimed by the petitioner.

7. OTHER OPERATING INCOME

7.1. Petitioner's Grounds for Review

7.1.1. The petitioner has stated that accounting for the impact of increased US $ / rupee parity and actual sale and purchase volumes for part of the year, it has increased the estimated gas transportation income, sale of gas condensate and royalty & transportation income from JJVL for the said year by Rs. 1,169 million. The breakup of revised other operating income in comparison with DERR has been provided as under:

Table 2: Comparative Analysis of Other Operating Income with DERR

			Rs. per MMBTU
Description	**DERR**	**The Petition**	**Increase**
Meter rentals	548	548	-
Late payment surcharge	348	348	-
Amortization of deferred credit	332	332	-
Sale of gas condensate	377	464	87
Meter manufacturing profit	104	104	-
Gas transportation charges	560	585	26
Transportation Income from JJVL	2,798	3,406	608
Royalty income from JJVL	2,059	2,507	448
Other income	175	175	-
Total Other Income	**7,302**	**8,471**	**1,169**

7.2. Discussion & Decision

7.2.1. The petitioner has filed this petition under Section 8(2) of the Ordinance which requires review of the revenue requirement after incorporating the actual changes in the well-head prices, as notified by the Authority and other relevant factors. The relevant factors, in this context, include actual sale and purchase volumes, latest trend of international crude oil and HFO prices and US $ exchange rate.

7.2.2. Revised operating income on the basis of adjustment of US $ exchange rate discussed in para 6.2.5 above, is provisionally determined at Rs. 8,001 million as against Rs. 8,471 million claimed by the petitioner.

8. INTERSTATE GAS (Pvt.) SYSTEMS LTD.

8.1. Petitioner's Grounds for Review

8.1.1. The petitioner has submitted that an amount of Rs. 1,668 million has been excluded by the Authority in ERR for the said year on account of ISGSL expenditure, subject to receipt of policy guidelines from the GoP under Section 21 of the Ordinance.

8.1.2. The petitioner has now claimed Rs. 578 million as its 51% share of the revenue expenditure of ISGSL, pursuant to receipt of policy guideline of GoP dated September 10, 2008.

8.2. Discussion & Decision

8.2.1. The Authority observes that GoP, under Section 21of the Ordinance, has issued following policy guidelines vide MPNR letter No.4/3/2008-RA-II/OGRA, dated September 19, 2008:-

> "***the revenue expenditure of ISGSL would continue to be included in the operating costs of Sui Southern Gas Company Limited and Sui Northern Gas Pipelines Limited at the ratio of 51:49 respectively to be recovered from gas consumers in form of consumer gas tariff.***"

8.2.2. The Authority had determined the Transmission & Distribution (T & D) cost at Rs. 4,537 million in ERR for the said year, after deducting Rs. 471 million on account of prior year adjustment of ISGSL expenditure.

8.2.3. On the basis of details received from ISGSL, its total revenue expenditure till FY 2008-09, was Rs. 675.81 million and the petitioner's share of 51% comes to Rs. 344.66 million. The Authority adds this amount in compliance of the Federal Government's above policy guideline and consequently determines the T & D cost of the petitioner at Rs. 4,882 million, as against the claimed amount of Rs. 5,586 million.

9. UFG ADJUSTMENT

9.1. The Authority, while determining the ERR for the said year, had fixed the UFG upper & lower targets at 5.50% & 4.80% respectively, with the condition that the petitioner would (i) retain the savings in the event of performance being better than the lower target, (ii) fully bear the loss for UFG above the upper target from its own profits, and (iii) absorb 50% of the loss on account of UFG between the lower and upper target in the event of final UFG percentage being within these two limits, while the remaining 50% would be adjusted in the revenue requirement.

9.2. The petitioner has projected UFG at 6.64% for the said year. The Authority observes that according to the benchmark, 100% UFG above 5.50% (upper target) and 50% UFG between 5.50% and 4.80% (lower target) should not be made part of revenue requirement and therefore provisionally deducts Rs. 1,572 million from the revenue requirement of the petitioner.

10. WORKERS PROFIT PARTICIPATION FUND (WPPF)

10.1. The petitioner has claimed WPPF at Rs. 125 million. ***However, due to adjustments in the components of revenue requirements as discussed above, WPPF is recalculated and provisionally allowed at Rs. 52 million.***

11. DETERMINATION

11.1. After comprehensive review of all the points raised by the stakeholders, and in pursuance of the directive of the Federal Government issued on October 11, 2002 under Section 47 of the Ordinance, the Authority has decided the matter of LPS and MMP earlier. The Authority's summarized view point, elaborated in detail in earlier decision, is given below:

> *"Treatment of any component of the tariff regime (e.g. LPS & MMP) can not be changed in isolation, while the petitioner continues to get return @ 17% on fixed assets as stipulated in loan covenant. The tariff regime is package and has to be enforced in totality. These issues can, however, be sorted out while finalizing the new tariff regime".*

No new argument has been advanced to warrant any change in this decision.

11.2. The Authority has comprehensively addressed the issue of royalty from JJVL in its several earlier determinations and the decision in this regard has attained finality. The Authority has also decided the issue pertaining to treatment of sale of gas condensate as operating income in FRR FY 2007-08 dated September 23, 2008. The Authority again reiterates that royalty from JJVL and income on account of sale of gas condensate arises from the use of assets / system relating to regulated activities, which has been financed over the years through gas price mechanism. Similarly, depreciation, other operating expenses and return related to these assets have always been claimed by the petitioner as part of revenue requirement. The Authority also notes that the petitioner's role is that of a transporter / carrier of gas to respective localities, for which it is being paid adequate return on its assets. Any return above the agreed return on assets would be against the intent of the Rate of Return mechanism and would be detrimental to the interest of the consumers at large.

11.3. The Authority, after taking into consideration the points raised by the interveners, the clarifications provided by the petitioner, scrutiny of the petition and available record, provisionally determines the shortfall in the estimated revenue requirement for the said year at Rs. 3,621 million, as against Rs. 22,262 million claimed by the petitioner and since sale prices cannot be increased retroactively, decides to recover it in the remaining six months, i.e. January - June, 2009. It is not necessary or feasible in light of the time frame provided in Section 8 (3) of the Ordinance, to increase the prices according to the petitioner's requested date of December 01, 2008.

11.4. In view of the above, the Authority, in exercise of its powers under Rule 5 (7) of the NGT Rules, 2002, provisionally allows an increase of Rs. 18.55 per MMBTU (***Annexure-I***) in the average prescribed price of the petitioner w.e.f. January 01, 2009 to enable it to recover the estimated shortfall of Rs. 3,621 million in its ERR for the said year. Revised schedule of prescribed prices of the petitioner w.e.f. January 01, 2009 is at ***Annexure-II***. It incorporates increase in prescribed prices of the consumers at 7.83% for all categories of consumers *except* feedstock supply to the fertilizer consumer, governed by a separate policy.

11.5. A comparison of the revised provisional prescribed prices w.e.f January 01, 2009 and the current sale prices is at ***Annexure-III***. The revised provisional prescribed prices are subject to the condition that these *"may be re-adjusted 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 increase in the average prescribed price remains unchanged so that the petitioner is able to achieve its total revenue requirements in accordance with Section 8 (6) (f) of the Ordinance."*

11.6. **Under Section 8 (3) of the Ordinance, the Federal Government is required to advise the Authority, within 40 days of advice from the Authority of revision of prescribed prices, the minimum charges and the sale price for each category of retail consumers, for notification in the Official Gazette by the Authority. Further, under Section 8 (4) of the Ordinance, if the Federal**

Government fails to so advise within the said 40 days and the prescribed price for any category of retail consumers determined by the Authority is higher than the most recently notified sale price for that category of retail consumers, the Authority shall notify in the Official Gazette the prescribed price as determined by the Authority to be the sale price for the said category of retail consumers. In such an unlikely, and undesirable eventuality, all the categories, except fertilizer feed-stock, will be affected. That will also result in different retail prices being charged by the petitioner and SNGPL for some categories of retail consumers violating the prevalent GoP policy of maintaining uniform prices for retail consumers throughout Pakistan.

11.7. **In view of above legal position, the Federal Government may take necessary action under Section 8 (3) of the Ordinance and advise the Authority latest by December 30, 2008, the revised sale price for each category of retail consumers of natural gas for notification in the Official Gazette, to be effective from January 01, 2009. In this context, the Authority strongly recommends to the Federal Government to consider on merit the arguments advanced and points made by stakeholders on policy issues through written interventions and in the course of public hearing, which are summarized in Section 4 above.**

(Syed Hadi Hasnain)
Member (Gas)

(M.H. Asif)
Member (Finance)

(Rashid Farooq)
Member (Oil) /
Acting Chairman

Islamabad,
November 20, 2008.

I. Computation of Estimated Revenue Requirement for FY 2008-09

Rs. in Million

	Particulars	The Petition	Adjustment	Determined by OGRA
Gas sales volume -MMCF		402,150		402,150
	BBTU	381,207		381,207
"A"	**Net Operating Revenues**			
	Net sales at current prescribed price	106,250		106,250
	Meter rentals	548		548
	Late payment surcharge	348		348
	Amortization of deferred credit	332		332
	Sale of gas condensate	464	(28)	436
	Meter manufacturing profit	104		104
	Gas transportation charges	585	(7)	578
	Transportation Income from JJVL	3,406	(283)	3,123
	Royalty income from JJVL	2,507	(152)	2,355
	Other income	175		175
	Total Operating Revenue "A"	**114,721**	(470)	**114,251**
"B"	**Less: Operating Expenses**			
	Cost of gas	124,222	(18,560)	105,662
	UFG Adjustment	(1,849)	277	(1,572)
	Transmission and distribution cost	5,586	(704)	4,882
	Gas internally consumed	208	(385)	177
	Depreciation	2,771		2,771
	Other charges including (W.P.P.F)	145	(93)	52
	Total Operating Expenses "B"	**131,083**		**111,972**
"C"	**Operating profit (A-B)**	**(16,363)**	(19,465)	**2,279**
Return required on net operating fixed assets:				
Net operating fixed assets at beginning		32,260		32,260
Net operating fixed assets at ending		36,866		36,866
		69,126		69,126
Average net assets (I)		**34,563**		**34,563**
"E" 17% return required		**5,876**		**5,876**
"F" Shortfall in return required (C-E) (Gas Operatio		**(22,238)**		**(3,597)**
"G"	**Additional revenue requirement for Air-Mix LPG Project**	**24**		**24**
Total Shortfall (F+G)		**22,262**	(18,641)	**3,621**
"H"	**Projected gas sale (BBTU) from December, 08 to June, 09.**	**227,799**		
Requested increase in average prescribed price w.e.f Dec 01, 2008 (Rs. / MMBTU)		**97.73**		
"I"	**Projected gas sale (BBTU) from January, 09 to June, 09.**			**195,262**
Determined increase in average prescribed price w.e.f Jan 01, 2009 (Rs. / MMBTU)				**18.55**
Estimated revenue requirement (B+E+G)		**136,983**		**117,872**
Average Prescribed Price (Rs. per MMBTU)		**337.12**		**288.22**

II. Provisional Prescribed Prices for FY 2008-09 w.e.f. January 1, 2009

		Prescribed Prices w.e.f. 01.07.2008	Prescribed Prices w.e.f. 01.01.2009
		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	84.52
	Second slab (over 50 upto 100 cubic metres per month)	82.07	88.49
	Third slab (over 100 upto 200 cubic metres per month)	149.40	161.09
	Fourth slab (over 200 upto 300 cubic metres per month)	313.10	337.61
	Fifth Slab (over 300 upto 400 cubic metres per month)	407.31	439.19
	Sixth Slab (over 400 upto 500 cubic meters per month)	529.50	570.94
	Seventh Slab (over 500 cubic meters per month)	688.35	742.23
	The lower price benefit of only two preceeding slabs would be available to consumer falling in any particular slab		
	For hostels and residential colonies to whom gas is supplied through bulk meters.		
	All off-takes at flat rate of	149.40	161.09
(ii)	**Special Commercial Consumers (Rooti Tandoors):**		
	First slab (upto 50 cubic metres per month).	78.38	84.52
	Second slab (over 50 upto 100 cubic metres per month)	82.07	88.49
	Third slab (over 100 upto 200 cubic metres per month)	149.40	161.09
	Fourth slab (over 200 upto 300 cubic metres per month)	313.10	337.61
	Upto 300 cubic meters, billing is to be done in accordance with the domestic sector mechanism whereas those consuming above 300 cubic meters will be billed as normal.		
(iii)	**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	362.94	391.35
(iv)	**Ice Factories**		
	All off-takes at flat rate of	362.94	391.35
(v)	**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	322.55	347.80
(vi)	**Captive Power**		
	All off-takes at flat rate of	322.55	347.80

(vii)		**CNG Stations**		
		All off-takes at flat rate of	373.45	402.68
viii)		**Cement Factories**		
		All off-takes at flat rate of	428.89	462.46
(ix)		**Pakistan Steel**		
		All off-takes at flat rate of	322.55	347.80
(x)		**FFC Jordan Fertilizer Company**		
	(i)	*For gas used as feed-stock for Fertilizer.*	36.77	36.77
	(iii)	*For gas used as fuel for generating steam and electricity and for usage in housing colonies for fertilizer factories.*	322.55	347.80
(xi)		**Power Stations**		
		All off-takes at flat rate of	322.55	347.80
(xii)		**Independent Power Projects**	251.55	271.24

III. Comparison between existing sale prices and revised prescribed prices

Category	Sale Prices w.e.f 01.07.2008	Revised Prescribed Prices w.e.f. 01.01.2009	Differential (Gas Development Surcharge)
	Rupees per MMBTU		
Domestic			
1st Slab	78.38	84.52	(6.14)
2nd Slab	82.07	88.49	(6.42)
3rd Slab	149.40	161.09	(11.69)
4th Slab	313.10	337.61	(24.51)
5th Slab	407.31	439.19	(31.88)
6th Slab	529.50	570.94	(41.44)
7th Slab	688.35	742.23	(53.88)
Commercial	370.80	391.35	(20.55)
Special Commercial			
1st Slab	78.38	84.52	(6.14)
2nd Slab	82.07	88.49	(6.42)
3rd Slab	149.40	161.09	(11.69)
4th Slab	313.10	337.61	(24.51)
Industrial Consumers	329.54	347.80	(18.26)
CNG	388.32	402.68	(14.36)
Captive Power	329.54	347.80	(18.26)
Pak Steel	329.54	347.80	(18.26)
Cement	428.89	462.46	(33.57)
Power	329.54	347.80	(18.26)
Independent Power Projects	251.55	271.24	(19.69)
FFC-Jordan Fertilizer Company Limited			
Feed-stock	36.77	36.77	-
Fuel	329.54	347.80	(18.26)

IV. Crude Oil & HSFO Prices

Input Data For Calculation of Well-head Gas Prices for January, 09 to June, 09

Description	CRUDE OIL(ARABIAN LIGHT)	HSFO PRICE
		Daily
	$ PER BBL	$/ TON
Jun-08	129.9186	620.4981
Jul-08	132.7696	702.0314
Aug-08	114.8900	649.3338
Sep-08	96.7309	570.3491
Oct-08	67.6938	381.5957
*Nov-08	47.1700	212.9700
Avg. FOB price	98.1955	522.7964
Freight	0.8829	6.5160
C&F PRICE	**99.0784**	**529.3124**
* Estimted price		