



National Electric Power Regulatory Authority
Islamic Republic of Pakistan

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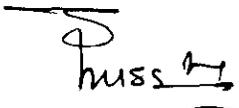
Registrar

No. NEPRA/R/TRF-40/FESCO-2005 /2498-2501
April 11, 2011

Subject: Decision of the Authority in the matter of Petition filed by Faisalabad Electric Supply Company Ltd. for Adjustment/Change in its Existing O&M Mechanism under Multiyear Tariff Regime [Case # NEPRA/TRF-40/FESCO-2005]

Enclosed please find herewith the Decision of the Authority (06 pages) in the matter of petition filed by Faisalabad Electric Supply Company Ltd. for adjustment/change in its existing O&M mechanism under Multiyear Tariff Regime in Case No. NEPRA/TRF-40/FESCO-2005, for information please.

Encl: As above


(Syed Safer Hussain)

Secretary
Ministry of Water & Power
'A' Block, Pak Secretariat
Islamabad



CC:

1. Secretary, Cabinet Division, Cabinet Secretariat, Islamabad.
2. Secretary, Ministry of Finance, 'Q' Block, Pak Secretariat, Islamabad.
3. Secretary, Privatization Commission, EAC Building, Islamabad.

**DECISION OF THE AUTHORITY IN THE MATTER OF PETITION FILED BY FAISALABAD
ELECTRIC SUPPLY COMPANY (FESCO) FOR ADJUSTMENT/ CHANGE IN ITS EXISTING O&M
MECHANISM UNDER MULTI YEAR TARIFF REGIME .**

1. Background

h A multi-year tariff of Faisalabad Electric Supply Company (hereafter "FESCO") was determined by the Authority on February 23, 2007 (detailed determination issued on 12th March 2007) , which was notified in the official Gazette vide SRO NO. 155(I)/2007 dated 24th February 2007. In the said determination, the Authority had prescribed a mechanism for O&M Adjustment. The mechanism being part of the Order of the Authority was also notified through the aforementioned S.R.O. Now the FESCO has filed a petition dated 30.9.2010 seeking adjustment in the said O & M adjustment mechanism. In support of its petition for making adjustments/ variations in the O&M mechanism, the petitioner took a stance that the existing formula based tariff needs revision in the O&M component of Distribution Margin to cope with a significant increase in Pay and Allowances by GoP as well as loss caused to the operational infrastructure due to the recent devastating flood in the country.

1.2 The grounds and facts forming the basis of the petition as per FESCO are as under:-

"Uncontrollable items like pay and allowances have increased much more than the assumed level and are required to be adjusted annually to meet the gap between the actual increase announced by the Government of Pakistan in Pay and Allowances and that comes through the multi year tariff formula as per NEPRA mechanism. NEPRA's formula allows for bottom line budget and annual increase in O&M as per existing mechanism is absorbed mainly by increase in pay and allowances. Indexation of O&M cost and a new mechanism for annual increase in O&M part of the Distribution Margin (DM) to absorb the annual increase in pay and allowances and inflationary impact on other heads like repair and maintenance, transportation, This enhancement is required till the remaining period of multi year tariff, that is upto 23rd February, 2012". In terms of rule 4 of the Tariff Standards and Procedure Rules 1998 (hereinafter referred to a "Rules"), the Petition was admitted by the Authority on 14th October 2010 and in compliance of the provisions of sub rules (5) & (6) of rule 4 of the Rules, notices of admission were issued to the parties considered to be affected or interested and the title and brief description of the petition was also advertised through the national newspapers published on 26th October 2010 whereby filing of reply, comments or intervention requests within 15 days by the interested persons was also desired.

2. Filing of reply/comments/intervention requests

2.1 In response to the notice of admission, Central Power Purchasing Agency (CPPA) within National Transmission & Despatch Company Limited (NTDC) filed its comments.. *↓*



2.2 In its comments, CPPA stated that the ever increasing tariff has already crossed the limit of consumers' capacity to pay for the electricity and the services provided by DISCOs with severe consequences including incentive to steal. It was also maintained by CPPA that any increase in tariff warrants very careful study and review by FESCO and the Regulator alike to demonstrate and ensure that the available human and material resources have been efficiently utilized; new investments and projects judiciously planned and executed; and efforts have been made to curtail non-development expenditures like vehicle, TA/DAs etc. The following comments were also offered by CPPA:-

- The basis or break-down of the financial impact of Rs. 674 million due to increase in employees salary @ 50% announced by the GoP has not been provided, Considerable detail such as Head office, Circle, Division and Sub-Division-wise including the man-power strength should also be provided.
- The justification for additional repair and maintenance costs of Rs.243.08 million due to damage of operational infrastructure in flood is too sketchy to be acceptable. Break-up of the total additional cost of Rs.243.08 million may be provided in terms of each related/affected area.
- Similarly the justification for additional repair and maintenance cost of Rs.66.25 million due to damage of GSO (Grid System Operations) infrastructure should also be provided.
- The additional repair and maintenance costs of Rs.243.08 million and Rs.66.25 million claimed respectively due to damage of operational and GSO infrastructure in the recent flood is a one time expense and should not become part of the O&M expenses for subsequent years.
- FESCO should demonstrate its efforts in curtailing non-development expenses in support of the efficiency factor determined by NEPRA.
- 15.53% growth in energy sold from 8317 MkWhr in 2009-10 to 9607 Mkwhr in 2010-11 (Reference: Table on page 7 of the petition) is quite high compared to 2.18% rise during the previous year from 2008-09 to 2009-10. FESCO may be advised to offer the rationale for the excessive growth assumed.

3. Hearing

3.1 The pleadings so available on record were examined by the Authority in terms of rule 9(1) of the Rules for the purposes of arriving at a decision as to conduct of hearing or otherwise and the Authority did consider it appropriate to conduct a hearing to arrive at a just and informed



decision. The Authority decided to hold the hearing in the matter on 29th November, 2010 and a fourteen days notice as required under rule 9(4) of the Rules was published in the newspapers on 16th of November, 2010 inviting participation of the stakeholders. Individual letters were also sent to the parties as well as other stakeholders.

3.2 The following issues were framed for presenting written or oral arguments on the petition and production of evidence, if any, during the course of hearing:

1. Whether the issues raised by commentator are justified?
2. Whether the ground of the petition and claim regarding adjustment in FESCO's existing O&M adjustment mechanism under multi-year tariff regime is justified?

3.3 The hearing was initially scheduled to be held on 29th November, 2010, however, due to un-avoidable circumstances, it was rescheduled for 2nd of December, 2010. Due notices to all concerned were issued and the hearing into the matter was conducted on 2nd of December, 2010.

3.4 On the date of hearing, the representatives of the petitioner/FESCO were heard and record perused by the Authority. No one appeared on behalf of the commentator, i.e., CPPA. On the basis of pleadings, evidence/record produced and arguments raised on behalf of the petitioner, issue-wise findings of the Authority are given as under:

4. Issue # 1. Whether the issues raised by commentator are justified?

4.1 The Authority considers that the comment with respect to the details of salary increase and additional repair and maintenance, raised by the Commentator is justified as the Petitioner did not provide any break-down of the financial impact of Rs. 674 million resulting from an increase in employees salary @ 50% announced by the GoP and the justification for additional repair and maintenance costs of Rs.243.08 million and Rs.66.25 million due to flood damages of operational infrastructure and of GSO infrastructure respectively. In the absence of relevant details/evidence, the Authority was unable to validate the Petitioner's contention in this regard.

4.2 The comment pertaining to the curtailment of non development charges is valid but as FESCO is allowed a multiyear tariff and according to the very spirit of multiyear tariff any benefit due to the curtailment of non development charges would be retained by FESCO itself. If the commentator feels that there are some extra non development charges, it is FESCO who would bear its consequences, since the O&M existing mechanism, only allows inflationary impact (adjusted with an annual predetermined efficiency factor)



4.3 The comment of 15.53% growth in energy sold is irrelevant as the Authority while doing quarterly adjustments used to adjust the same to actual sales growth in order to ensure 100% recovery of assessed fixed costs for any year.

5. Issue #2. Whether the ground of the petition and claim regarding adjustment in FESCO's existing O&M adjustment mechanism under multi-year tariff regime is justified?

5.1 As per FESCO, the grounds of the petition for changing existing O&M adjustment mechanism under multi-year tariff regime, were taken from the Authority's determination dated 23rd February 2007, (under the head of *Retail Tariff Adjustments*, sub head *Extraordinary Adjustments*) which states ;

"Any justified losses and/or additional expenses incurred by FESCO due to changes in Pakistani legislation, corporate income tax, legal acts, technical regulation, political force majeure or other special events that are beyond FESCO's control would be reimbursed by adjusting the distribution margin, subject to NEPRA's prior approval."

5.2 According to FESCO, the above referred decision establishes its right to request adjustment in its existing O&M mechanism, due to the following uncontrollable cost hikes;

- Increase in employee's salary @ 50% announced by GOP having financial impact of Rs.674 million.
- Additional Repair & Maintenance cost of Rs.243.08 million to operational infrastructure and Rs.66.25 million to GSO infrastructure damaged by flood.

5.3 In order to substantiate its claim, FESCO has submitted the comparison of increase in pay and allowances only against NEPRA total O&M budget which is given hereunder:

Description	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
NEPRA Total O&M budget	3,393	3,577	4,159	4,870
Actual O&M Expenditure (including provisions)	3,454	3,790	4,536	5,296
Actual O&M Expenditure (excluding provisions)	3,192	3,381	3,872	4,697



- 5.4 } According to FESCO, its actual O&M expenses remained in excess of budget allocated by NEPRA during the above mentioned years. The excess amount over budget actually involved the net provision for retirement benefits as well as doubtful debts. Provisions made, were Rs. 262, Rs. 409, Rs.664, Rs.599 million for FY 2006-07, FY 2007-08, FY 2008-09 and FY 2009-10 respectively. According to FESCO, the overall O&M expenditure after excluding the impact of such provisions is within the limit allowed by the Authority.
- 5.5 In addition to above, FESCO submitted a working to justify additional impact of repair and maintenance of Rs.243.08 million to operational infrastructure and Rs.66.25 million to GSO infrastructure damaged by flood.
- 5.6 The submissions so raised by the petitioner/FESCO have been examined. Firstly, the ground of the petition, as claimed by FESCO, is not correct. The above referred extract of the determination is not the decision of the Authority; in contrast, it is part of FESCO's submission at the time when petition was made. The above referred decision, no where specifically endorses such request/submission of FESCO.
- 5.7 FESCO is allowed a multi year performance based tariff, which ensures the benefits of any operational efficiencies and simultaneously penalizes for any inefficiency. For instance if FESCO manages to reduce its actual T&D losses from the target set by the Authority for any period, its benefits would be retained by the FESCO. Like wise, if T&D losses are increased from the targets, any under recovery on this part would not be adjusted in the FESCO's revenue requirement. The same principle applies to the assessment of O&M costs. In view thereof, FESCO's stance of justifying it through the audited figures of the previous years, is against the basic spirit of multi year tariff.
- 5.8 The prudence/reasonability of the assessment through the existing mechanism could be checked by comparing it with similar DISCOs. In the instant case, FESCO's assessment of O&M cost for the FY 2010-11 is 18% and 27% higher than what has been assessed for IESCO and GEPCO pertaining to the same period. Further, as stated by FESCO itself, the reason for the difference is on account of provision for bad debts and provision for retirement benefits. Here it is pertinent to mention that for the FY 2010-11, the Authority has disallowed provision for bad debts, even in the cases of QESCO, PESCO and HESCO, where specifically the Authority had been allowing it in the past. As far as the provision for retirement benefits is concerned, the Authority, even in the case of single year tariff, no where allows this based on the audited figures. Hence, FESCO's argument on this account is not valid.
- 5.9 On the issue of additional impact of repair and maintenance of Rs.243.08 million to operational infrastructure and Rs.66.25 million to GSO infrastructure damaged by flood, it is expected that commercial organizations normally use different insurance covers against any situation which is beyond their control. FESCO also deals with different banks where only insured assets are accepted as collaterals. It appears that FESCO's current insurance cover does



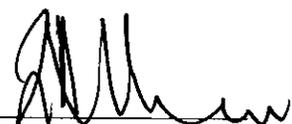
not include damages due to natural disasters, hence has requested to transfer the whole burden to its consumers, which is not justifiable.

5.10 Further, as rightly pointed out by the Commentator, that the information provided by FESCO is too sketchy to be acceptable. FESCO has totally ignored to substantiate its submission with any credible evidence, such as independent identification and valuation of damages claimed. FESCO has provided a simple working in this regard to establish its view point. Thus the petitioner has miserably failed to substantiate its request with any valid reasons.

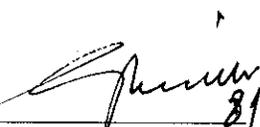
6. ORDER

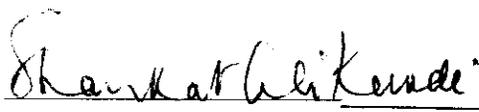
6.1 In view of aforementioned and considering the spirit of performance based tariff, the Authority concludes that FESCO has completely failed to justify its case with respect to petition filed for change in existing O&M adjustment mechanism under multi-year tariff regime, therefore, the petition is declined.

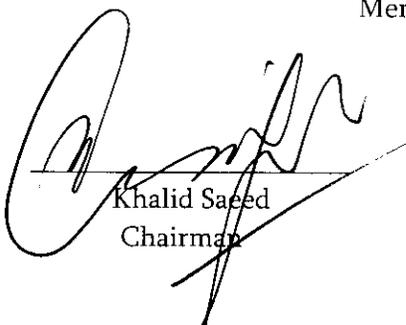
AUTHORITY

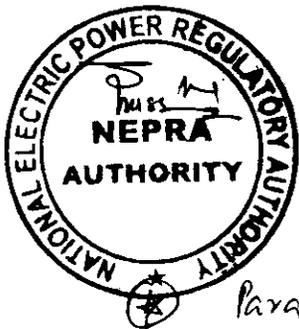

(Zafar Ali Khan)
Member
6/4/11

(*)
(Maqbool Ahmad Khawaja)
Member


(Ghiasuddin Ahmed)
Member
8/4


(Shaukat Ali Kundi) 08.04.2011
Member/Vice Chairman


Khalid Saeed
Chairman



Para 5.9 is not agreed as I am of opinion that "Flood 2010" was not simple matter rather a Force majeure & beyond control. Due to its havoc nature it destroyed installations/distribution system on a large scale. As such Disc. Disc. w/c FESCO must be compensated. However quantum of damage need to be substantiated by FESCO. Not to allow at all will not be fair.

Wg/4
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MAQBOOL AHMAD KHAWAJA
M(S)