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Islamic Republic of Pakistan

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No. NEPRA/TRF-215/FESCO-2012/11396-11398
September 18, 2013

Subject: Decision of the Authority in the matter of Motion for Leave for Review filed by Faisalabad Electric Supply Company Ltd. against Tariff Determination of the Authority dated 29.03.2013 (Case No. NEPRA/TRF-215/FESCO-2012)

Dear Sir,

Please find enclosed herewith the subject Decision of the Authority (07 pages) in the matter of Motion for Leave for Review filed by Faisalabad Electric Supply Company Ltd. against Authority's Tariff Determination dated 29.03.2013 in Case No. NEPRA/TRF-215/FESCO-2012 for information.

Enclosure: 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, Islamabad.



**DECISION OF THE AUTHORITY IN THE MATTER OF MOTION FOR LEAVE FOR
REVIEW FILED BY FAISALABAD ELECTRIC SUPPLY COMPANY (FESCO) AGAINST
TARIFF DETERMINATION OF THE AUTHORITY DATED MARCH 29, 2013**

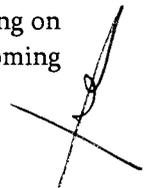
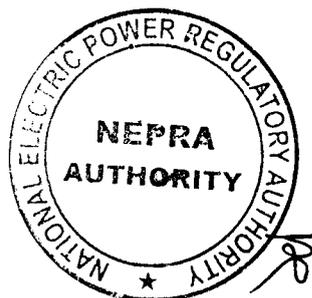
Vide determination dated March 29, 2013, consumer-end tariff for Faisalabad Electric Supply Company Limited (FESCO) pertaining to the FY 2012013 was determined by NEPRA. Being aggrieved from said determination, FESCO has filed a motion for leave for review on the following issues / contentions:

- i) Insufficient amount allowed by the Authority for pay and Allowances including Retirement benefits;
- ii) Special Repair and Maintenance amounting to Rs. 651 million disallowed by the Authority;
- iii) Certain Prior year adjustment denied by the Authority;
- iv) Rational for Adjustment of 2nd quarter of FY 2012-13 not clear;
- v) Return on Regulatory asset base not sufficient;

2. In order to consider the motion for leave for review, opportunity of hearing was provided to the petitioner as well as other concerned parties. The Petitioner in its Review Motion pleaded that the observations of the Authority which disallowed new recruitments is against the fact since the same were made after adopting the due legal procedure and these employees are being paid salary and other benefits duly reflected in audited accounts. Further, the Petitioner intimated that future recruitment plan has been submitted with the original tariff petition as it is the prerogative of the company to hire staff with the approval of board of directors as allowed under Companies Ordinance, 1984.

3. During the hearing, the Petitioner presented that there are 2,589 vacancies in different cadre lying vacant in FESCO and only those recruitments are made that are replacement hiring, therefore an expense of Rs 230 million deducted by the Authority from base expense on account of new recruitments should be allowed.

4. After careful consideration of the Petitioner' argument the Authority is of the view that the para 12.4.4 and 12.4.6 of the determination dated 29th March, 2013, fully explains the rationale for its decision with respect to new recruitments. The Authority disallowed cost relevant to new recruitments, as reported by the Petitioner and directed to verify this expense on new recruitments from an auditor and furnish a certificate in this regard. The purpose was to get the reported figure verified from a third party. Provided that no litigation is pending on the said cost, the Authority would allow the same (as a tariff adjustment) in the upcoming



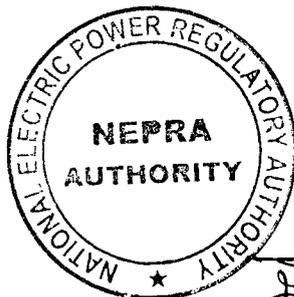


tariff petitions. Here it is pertinent to mention that the Petitioner has not substantiated its request with the required evidence. During the hearing, the Petitioner argued that the impact of Rs.230 million is already reported in the audited financial statements which are audited by Chartered Accountants. The Authority considers that it is a matter of common sense that the audited accounts reflect the actual state of affairs of a company, which would definitely include the impact of additional recruitments worth Rs. 230 million, but what is required here is a separate disclosure on this account and get the reported figure verified from a third party. In view thereof, during the hearing, the Petitioner was again directed to submit the certificate along with details pertaining to recruitments.

5. In this regard, petitioner has responded vide letter no. 28301/Tariff dated 25th June, 2013 and submitted court decisions on recruitment and minutes of board of director's meetings in which recruitments were approved. The Petitioner however, failed to submit auditor's certificate or expense details of recruitments as required by the Authority. As far as the issue of new recruitments is concerned, the aforementioned paras of the determination dated 29th March, 2013 clarify the Petitioner's future course of action. The one pager recruitment plan of the Petitioner, submitted along with its original petition, was dully considered by the Authority while deciding on the matter. The aforementioned recruitment plan merely mentioned the vacant posts but lacked the justification as how these additional recruitments would make an ordinary electricity consumers life easier in terms of better services OR how these would make Petitioner's operations better and efficient which would eventually result in improved quality of service. It is also worth mentioning that the Petitioner's sales are not likely to increase due to the reason discussed under issue # 4 of the impugned determination.

6. The Authority has also considered the Petitioner's argument with respect to the powers of Board of Directors for giving approval of hiring staff under Companies Ordinance, 1984. The Authority has no disagreement on the powers of Board of Directors; however it has to act under the provisions of NEPRA Act for brining efficiency in the power sector and protecting consumers interest. Only prudently incurred costs are to be allowed and not the actual costs. In view thereof the onus of justifying the costs on the basis of prudence is on the petitioner, which in the instance case the Petitioner failed to justify.

7. Considering the fact that the Petitioner has failed to provide the auditor certificate justifying the expense, the Authority is constrained to allow any cost in this regard pursuant to its earlier decision dated 29th March, 2013 and directs the Petitioner to strictly follow Authority's directions with respect to additional recruitments, already notified in the decision dated 29th March, 2013. The Petitioner is however, again directed to furnish external Auditor's certificate in this regard with its petition pertaining to the FY 2013-14 for the Authority's consideration.





8. The Petitioner in its petition contended that as per Financial Statements of FY 2011-12, the actual pay and allowances and retirement benefits excluding provision for retirement benefits comes to Rs. 5,138 Million. The Authority has allowed total increase of Rs. 422 Million over this actual cost of Rs. 5,138 Million of the last year duly verified by audited accounts statement. Simple increase of 20% (that is allowed by NEPRA) only on the basis of the last year actually incurred by the Petitioner would make increase of 443 Million. The Petitioner further elaborated that during the first eight months of the FY 2012-13, it has already incurred Rs. 4,290 million(including Bonus) and at the pace , the expected cost in the head of pay and allowances shall be Rs. 6,246 million (excluding Rs. 189 million as per NEPRA's Orders). Thus, the net result would be Rs. 6,246 million.

9. The Petitioner during the hearing pleaded that the actual expense incurred upto April, 2013 is Rs. 5,380 million which if extrapolated to entire year comes to Rs. 6,435 million. Further, the petitioner presented following break-up of expense incurred:

Description / Period	Basic pay	Allowances	Regular employee benefits	Post retirement benefits paid	Total
Projected expense for FY 2012-13 (Rs in million)	2,471	2,483	384	1,097	6,435

10. The petitioner claimed the entire cost as prudent and unavoidable and requested for approval of additional amount in this head of Rs. 686 million. The Petitioner was directed by the Authority in the Review motion hearing to submit details of certain benefits being paid to employees which was furnished by the Petitioner vide letter no. 28301/Tariff dated 25th June, 2013.

11. The Authority while determining the consumer end tariff has explained in detail the rationale for allowed cost in para 12.4.6 of the determination dated 29th March, 2013 stating that the increase in actual salary expense reported by the Petitioner for FY 2011-12 was substantial when compared with other DISCOs. The pay and allowances for the FY 2012-13 was allowed as Rs. 5,560 million after incorporating all the allowed GOP increases in salary and allowances. Also, if the Petitioner comply with the directions of the Authority by creating an independent





post retirement benefit fund, any provision made to this fund would be allowed on actual basis.

12. The Authority while considering Petitioner's arguments pertaining to its actual results for the FY 2011-12, compared the reported figure of 5,138 million with its audited accounts for the same period. It was observed that the total amount against the head of Salaries wages & other benefits (excluding provision for post retirement benefits) was Rs. 4,188 million , if the actual payments on account of post retirement benefits was taken into account, the same figure works out as Rs. 5,003 million, which does not reconciles with the reported figure in the motion for leave for review. Further, the Petitioner while calculating the allowed increase has not incorporated the impact of Rs. 230 million (currently disallowed by the Authority), pertaining to the recruitments from 2009-10 and onwards. Thus, the calculation provided does not support Petitioner's argument. As regard the provisional figures pertaining to the FY 2012-13, these would be considered in the next year's tariff petition i.e. for the FY 2013-14. In view thereof, the Authority considers that the Petitioner's arguments in support of allowing enhanced O&M cost are not valid; therefore the Authority has decided to maintain its earlier decision.

13. The Petitioner pleaded that it requested for an amount of Rs. 1,206 million on account of repair and maintenance expense of which Rs. 651 million pertained to special repair and maintenance of damaged and sick transformers. The Petitioner stated that this expense is necessary for ongoing operations and is not covered under Investment expense of Energy loss reduction (ELR). The Petitioner also referred International Accounting Standard (IFRS) 15 which allows it to treat this cost as an expense and requested the approval of the same (presented in its presentation during the Hearing of motion for leave for review).

14. The Authority considered the Petitioner's request and is of the view that it has discussed the issue in detail under para 12.5.3 and 12.5.4 of the determination dated 29th March, 2013 and termed the same cost as duplication considering repair and maintenance expense is being allowed to the Petitioner over the years and also significant amount is allowed annually under investment expense to meet expenses of this nature. As far as the IFRS 15 is concerned, it is pointed out that the IFRS 15 as referred by the Petitioner does not exist any more, it is IAS-16 that relates to property plant and equipment and para 7 of the standard clearly states that any cost shall be recognized as an asset in case the future economic benefits associated with the cost flow to the entity and the cost is reliably measured. Further under para 12 and 13, the IAS 16 allows cost of day-to-day servicing of the asset to be recognized as repair and maintenance, whereas the cost of replacement of parts and major repair of the asset to be recognized as increase in cost of the asset. The cost of special repair and maintenance as requested by the Petitioner comprises of repair of sick transformers and replacement of transformers which does not come under day to day maintenance and hence cannot be allowed as an expense rather it should be capitalized as per the requirements of IAS-





15. Consequently, the Authority has denied the expense in its decision dated 29th March, 2013 and referred to the investment allowed under the head of Energy loss reduction (ELR) amounting to Rs 650 million which covers this expense. The Petitioner pleaded during the hearing for review motion that this requested cost is not capital in nature since for ELR proper cost benefit analysis is done and the same exercise has not been done for this expense. In Authority's view it is quite strange that the Petitioner intends to spend a cost of Rs.651 million, considering it as a "special repair and maintenance" and is unaware of its benefits. The Authority considers that the Petitioner does not understand the spirit of IAS-16 and the accounting policy relevant to this expense.

16. Further, Authority had been allowing increasing amounts under repair and maintenance head to the Petitioner over the years and the present huge number of sick and damaged transformers shows Petitioner's inefficiency. The Petitioner has presented reduction in losses in the FY 2011-12 by 0.34%, in the event where the Petitioner claims such large number of defected transformers in the system, it is incomprehensible that how it achieved reduction in losses. Therefore, contradictory statements have been made by the Petitioner to make its case for approval of expense.

17. The Petitioner submitted that it requested for prior year adjustment (PYA) of Rs. 25,227 million, whereas the Authority has approved Rs. 11,787 million. The Petitioner requested for allowing additional amount of Rs. 10,589 million. The Petitioner presented following break-up of the requested PYA:

Description	Additional PYA	Inconsistent application of Multi-year tariff
Additional Expense requested for FY 2012-13 (Rs in million)	5,762	4,827

18. As per the Petitioner the amount of Rs. 4,827 million relates to certain adjustments made by the Authority in the tariff calculation during multi-year tariff (MYT) regime and the same merits consideration due to legitimate cost of petitioner.

19. The detailed working of PYA has been provided in para 11.3 of the decision dated 29th March, 2013. The aforementioned para provides detailed component wise costs and their recoveries which formulates the assessed PYA for the FY 2012-13. As regards the matter of inconsistent application of MYT, it was also requested by the petitioner which was denied by the Authority in para 11.2 of the said decision. The rationale for denying the cost has been





given in detail in para 11.2. Since the Petitioner has not put forth any fresh evidence or ground; therefore the Authority has decided to maintain its earlier decision in this regard.

20. The Petitioner raised concern on the assessment of the 2nd quarter adjustment of FY 2012-13 amounting to Rs. 82 million as against the assessment of Rs. 2,735 million for the 1st quarter of FY 2012-13. The Petitioner contended that in the absence of any reason for such calculation it is not in a position to analyze the determination and requested to allow the 2nd quarters adjustment to the extent of Rs. 1,042 million. The petitioner objected to the facts stated in para 11.4 and 11.5 of the decision dated 29th march, 2013 and termed the same as mistake on the face of record and inconsistent with the provisions of law.

21. The Authority has carefully examined the working of the Petitioner with respect to the 2nd quarter and observed that the Petitioner has calculated its energy charge calculations on actual sales rather than on regulated sales, further the amount disallowed in the month of December, 2012 was also not accounted for. As regard the reasons for Authority's calculations, the FORM 6 (B) of the tariff petition provides the basis of quarterly adjustment's standard calculations, which probably has not been properly understood by the Petitioner. The Authority's decision was primarily with respect to not making the impact of 300 units part of Schedule-I, as this would distort the consumer-end tariff significantly. Considering this cost a legitimate cost for DISCOs, in the light of judgment of LHC and in view of statements issued by GOPs Counsel, the Authority directed the Petitioner to recover the amount from GOP (as subsidy) if it cannot recover it from consumers.

22. The Petitioner submitted that the return on regulatory asset base is insufficient and based its objections on the following grounds;

- dip in rate of return from 18.89% to 11.25% without reason;
- reference to other DISCOs is inappropriate as each has its own circumstances;
- debt to equity ratio of 80:20 is without any reference;
- values are based on assumptions and reference values;
- In para 14.7, the Authority admits the rate as equal to Rs. 2,565 million.

23. The 18.89 % return to which the Petitioner is referring to was calculated in prior years on the formula as specified in the MYT mechanism and may be referred in para 14.2 of the decision dated 29th March, 2013. This mechanism was a part of MYT and cannot be quoted in isolation. Further, the Petitioner's argument that it is different from other DISCOs in terms of management , finances , sources and other performance indicators is without any basis. The Petitioner failed to substantiate as how aforementioned factors would affect the Petitioner in a manner which would justify it with a different WACC.

24. The debt to equity ratio is assumed as 80:20 being optimal capital structure and keeping consumer interest in view. Had the Petitioner fully understood the concept of optimum capital structure and fixed nature of this cost, the Petitioner must not be calling it





reference values asking for its adjustments. Further, para 14.4 of the decision dated 29th March, 2013, gives the calculation of the Authority's assessment.

25. Lastly, in para 14.7, there was a typographical error owing to which the RORB was written as Rs. 2,565 million, however, the correct figure of Rs. 1,856 million has been written in the table under para 14.7, which also gives all the calculations for the allowed return. It appears that the Petitioner lacks understanding of the RAB calculations therefore was referring to the typo error rather than the complete calculations. This error has no financial implication, however, to correct this error, a corrigendum has already been issued vide letter no. NEPRA/TRF-215/FESCO-2012/5843-5848 dated June 13, 2013.

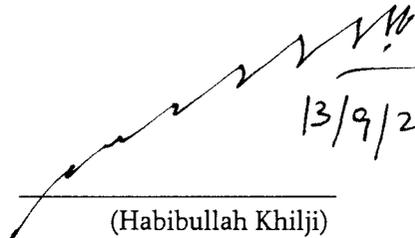
26. Having heard the Petitioner in support of its review petition, the Authority observed that the Petitioner failed to provide any additional or new justification in support of its reconsideration request. Keeping in view the above stated facts, the Authority is of the view that in terms of regulation 3(2) of the NEPRA (Review Procedure) Regulations, 2009, a motion seeking review of any order of the Authority is competent only upon discovery of new and important matter of evidence or on account of some mistake or error apparent on the face of record. The perusal of the determination sought to be reviewed clearly indicates that all material facts and representation made were examined in detail and there is no occasion to amend the impugned determination.

27. From what has been discussed above, the Authority is of the considered view that the grounds agitated in the motion for leave for review are not sufficient enough justifying the modification of the impugned determination, hence the motion for leave for review is declined.

AUTHORITY


16/9/13

(Major (R) Haroon Rashid)
Member


13/9/2013

(Habibullah Khilji)
Member


12 9 2013

(Khawaja Muhammad Naeem)
Vice Chairman




18.09.13