National Electric Power Regulatory Authority
Islamic Republic of Pakistan

Registrar

NEPRA Tower, Ataturk Avenue(East), G-5/1, Islamabad
Ph: +92-51-9206500, Fax: +92-51-2600026
Web: www.nepra.org.pk, E-mail: registrar@nepra.org.pk

No. NEPRA/TRF-133/KESC-2009/12889-12892
October 17, 2014

Subject:- **Decision of the Authority in the matter of Karachi Electric Supply Company Limited (KESCL) (Now K-Electric Limited) Request for Quarterly Adjustment in its Tariff for the Quarter Ended December 2013 and Transfer of a Portion of Profit for the Financial Year 2011-12 and 2012-13 to the Consumers as per the <u>Claw Back Mechanism [Case No. NEPRA/TRF-133/KESCL-2009(6)]</u>**

Dear Sir,

Please find enclosed herewith the subject decision of the Authority along with Annexure-I, II & III (17 pages) in respect of Karachi Electric Supply Company Ltd. in Case No. NEPRA/TRF-133/KESC-2009(6).

2. The Decision is being intimated to the Federal Government for the purpose of notification of the approved tariff in the official gazette pursuant to Section 31(4) of the Regulation of Generation, Transmission and Distribution of Electric Power Act (XL of 1997).

3. Please note that revised schedule of tariff attached to the Decision as Annex-III is required to be notified in the official Gazette. It is also informed that the applicability period mentioned in the last issued quarterly decision, i.e. July-September, 2013 of KESCL, sent to the Ministry of Water & Power vide letter No. NEPRA/TRF-133/KESC-2009/3173-3176 dated March 31, 2014 needs to be reviewed. The same being sub-judice in the High Court of Sindh, will be reviewed in light of the decision of the Honorable High Court of Sindh.

4. Please note that the SoT attached as Annex-III does not contain the figures of subsidy. The GoP, before notifying the attached SoT may consider intimating the Authority, in the manner prescribed in law, the category-wise subsidy, if any, to incorporate the same in the attached schedule.

Enclosure: <u>As above</u>

17/10/14

(Naweed Illahi Shaikh)

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 KARACHI ELECTRIC SUPPLY COMPANY LIMITED (KESCL) (NOW K-ELECTRIC LIMITED) REQUEST FOR QUARTERLY ADJUSTMENT IN ITS TARIFF FOR THE QUARTER ENDED DECEMBER, 2013 AND TRANSFER OF A PORTION OF PROFIT FOR THE FINANCIAL YEAR 2011-12 AND 2012-13 TO THE CONSUMERS AS PER THE CLAW BACK MECHANISM

BACKGROUND

1. Pursuant to section 31(4) of the Regulation of Generation, Transmission and Distribution of Electric Power Act, 1997 and in accordance with the determination of the Authority in case No. NEPRA/TRF-133/KESC-2009(6) notified vide S.R.O. No. 11(I)/2010 dated January 01, 2010, Karachi Electric Supply Company Limited (hereinafter referred to as the "KESCL") has been allowed certain adjustments in its tariff on quarterly basis. The adjustments allowed in the KESCL's tariff on quarterly basis include the following:

- Impact of variation in the fixed component of power purchase cost and variable operation and maintenance costs (hereinafter referred to as the "O&M costs") of power purchased by KESCL from the external sources.
- The impact of transmission and distribution losses (hereinafter referred to as the "T & D losses") not recovered in the monthly fuel charges adjustments (FCAs).

2. In addition to the aforesaid adjustments in tariff, for allowing KESCL recovery of its revenue in future on the latest price level, the tariff level is required to be adjusted to the price level of last month of the quarter i.e. in the current case, the price level of December, 2013.

CURRENT REQUEST

3. KESCL in accordance with the prescribed mechanism for adjustment of fuel cost and power purchase cost variation submitted quarterly adjustment request for the quarter October-December, 2013 (hereinafter referred to as the "current quarter") vide its letter No. RA&SP/NEPRA/071/030 dated January 20, 2014. Subsequently, KESCL vide letter No. RA&SP/NEPRA/071/1144 dated January 31, 2014 revised its aforementioned request, owing to revision in the invoice of NTDC for the month of December, 2013 and the decisions of the Authority in the matter of FCAs for the months of July, August & September 2013 issued on January 21, 2014. The summary of the requested tariff adjustment for the current quarter as claimed by KESCL is tabulated below:

Sr. No	Description	Proposed Adjustment
	Fuel Price Variation of December, 2013 over September, 2013 (Ps/kWh)	(92.459)
	Power Purchase Price Variation of December, 2013 over September, 2013 (Ps/kWh)	109.790
1	**Total Variation in Tariff (Ps/kWh)**	**17.331**
	Un Recovered Cost	
	Variation in O&M cost of IPPs and Other External Sources (Mill Rs)	261.377
	Variation in Capacity Charges of IPPs and Other External Sources (Mill Rs)	21.582
	Un-recovered cost of fuel in FCAs due to non-adjustment of T&D losses (Mill Rs)	34.537
	Revision of Fixed Cost of KANUPP	35.304
	Payment of WPPF to IPPs (TAPAL & GAEL)	144.153
	Total Unrecovered Cost (Mill Rs.)	**496.953**
	Estimated Units to be Sold in the next quarter (GWh)	2393
2	**Required Adjustments (Ps/kWh)**	**20.766**
3	**Adjustment of the Cost of Previous Quarter (Ps/kWh)**	**(3.079)**
	Total Required Adjustment in KESCL's Tariff (Ps/kWh) (1+2+3)	**35.018**

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4. In addition to the tabulated above costs adjustments, KESCL submitted that it should also be allowed prior period payments of WWF and WPPF to IPPs amounting to Rs. 435.423 million which was previously requested to be allowed as pass through item under unrecovered cost, however, not allowed by the Authority.

PUBLIC HEARING

5. Since the impact of tariff adjustment, if any, affects the consumers, therefore, in order to meet the ends of natural justice, the Authority considered it just and appropriate to provide an opportunity of hearing/ filing of objections/comments to all the stakeholders. Accordingly, a public hearing for consideration of the requested adjustment was scheduled by the Authority on March 31, 2014 (Monday) at Marriott Hotel, Karachi, however, due to impudent behavior of some of the participants, the Authority decided to adjourn the hearing. Subsequently, the Authority conducted the hearing on May 28, 2014 at Marriott Hotel, Karachi; notice thereof was published in the daily newspapers dated May 21, 2014 and separate notices were also sent to the major stakeholders inviting thereby comments/objections from the concerned stakeholders to make the process of hearing meaningful and to reach at an informed and just decision. The comments, related to subject matter of hearing, as submitted by different commentators are given hereunder;

6. Mr. Qazi Ahmed Kamal, representing Karachi Chambers of Commerce and Industry, submitted that the Authority vide its decision dated October 13, 2009 had directed KESCL to utilize fully its own generation capacity which is not being done by the utility. He further submitted that KESCL is relying only on gas and in case of its shortage does not produce electric power on furnace oil despite the fact that the end users are suffering from load shedding. Further, Mr. Kamal submitted that the prices of the IPPs and KESCL's furnace oil based generation are comparable then why the utility is not purchasing electric power from them despite paying them humongous amount of Capacity Charges. He also presented before the Authority a scenario by which if KESCL generates a certain level of capacity on furnace oil and purchases fully from furnace oil based external sources even then the average cost figure remained well below the allowed tariff of the utility. The authority noted that proceedings with respect to the under-utilization of power generation sources in KESCL's system (own + external sources) viz-a-viz load shedding have already been started and the case is under consideration of the Authority.

7. One of the commentators namely Mr. Mazhar Chaudhary questioned KESCL that what has been done by the company with the seven (07) decommissioned units each of 25 MW. Responding to that, KESCL submitted that it is the company's policy that the decommissioned units, after following certain procedure, are disposed off and after being audited from the company's auditors, i.e. KPMG, all the transaction details, i.e. sale proceeds, written down value, mode of disposal etc. are reflected in the annual accounts of the company in compliance of the provisions of Companies Ordinance, 1984.

ANALYSIS

8. The generation data and rates, as submitted by KESCL (both from self-generation and power purchased from external sources) were scrutinized with respective invoices and other underlying documents. KESCL's request for the current quarter has been discussed, in detail, under the following headings:

a) Changing the reference tariff from September, 2013 to December, 2013

b) Under-recovered costs for the Current Quarter

c) Reversal of tariff adjustment pertaining to the previous quarter i.e. Jul-Sep, 2013 which was applicable for the current quarter only

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a) **Changing the reference tariff from September, 2013 to December, 2013**

9. KESCL's last adjusted tariff is based on the fuel prices (both own generation and power purchase), O&M costs and capacity charges of September, 2013. For allowing KESCL, the recovery of its tariff in future on the latest price level, it is required that KESCL's tariff be adjusted to the price level of December, 2013. Changing the tariff level requires allowing variations in the fuel cost of KESCL's own generation as well as in the KESCL's power purchase cost (fuel cost, O&M costs and Capacity Charges) of December, 2013 over the reference month of September, 2013. KESCL has requested for allowing following adjustments in its tariff on this account:

Description	As Requested
Fuel cost variation of December, 2013 over September, 2013 (Mill Rs.)	(811.893)
Power purchase cost variation of December, 2013 over September, 2013 (Mill. Rs.)	964.077
Total Variation (Mill Rs.)	**152.184**
Units sold at 17% T&D losses for December, 2013 (GWh)	878.108
Required adjustment in tariff (Ps/kWh)	**17.331**

10. The Authority noted that main reason of the KESCL's claimed variations in the fuel cost component of its own generation is the decrease in generation on furnace oil, which has decreased from 216.726 GWh in the reference month of September 2013 to 45.894 GWh in the current month of December, 2013. Being a cooler month, the current month's demand was on the lower side which is the reason of low generation on furnace oil, submitted by KESCL.

11. In the power purchase cost, the Authority noted that the major reason for variation as claimed by KESCL was owing to the increase in cost of energy procured from NTDC which has increased from Rs. 8.248 /kWh in the month of September, 2013 to Rs. 10.814/kWh in the month of December, 2013.

12. A comparative analysis of the adjustment in KESCL's tariff required for bringing it to the tariff level of December, 2013 as requested and as approved by the Authority after verification of invoices and internal approvals (bill stickers) is tabulated below;

Description	As Requested	Approved
Fuel cost variation of December, 2013 over September, 2013 (Mill Rs.)	(811.893)	(811.325)
Power purchase cost variation of December, 2013 over September, 2013 (Mill. Rs.)	964.077	920.265
Total Variation (Mill Rs.)	**152.184**	**108.939**
Units sold at 17% T&D losses for December, 2013 (GWh)	878.108	878.106
Required adjustment in tariff (Ps/kWh)	**17.331**	**12.406**

13. The difference between the claimed and approved variation in fuel cost of own generation is due to inconsistency in the working of furnace oil rate (Rs/M.Ton) at KESCL's end. The Authority has consistently been using monthly weighted average method to work out the furnace oil rate and has used the same method for working out the tabulated above fuel charges variations.

14. In the power purchase cost component, it was noticed that NTDC/ CPPA, for the month of December invoiced KESCL at Rs. 8.975/kWh and the same was used by KESCL in its request whereas the Authority's approved fuel charges component of NTDC/CPPA, applicable to all XWDISCOs and KESCL, for the month of December, 2013 comes out to be Rs. 8.8793/kWh. The above variations have been worked out on the basis of Authority's approved fuel cost component of NTDC/CPPA.

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b) Over/Under Recovered costs for the current quarter

15. KESCL has requested for allowing adjustments of the following under-recovered costs:

Description	Requested by KESCL
Variation in O&M cost of IPPs and Other External Sources (Mill Rs.)	261.377
Variation in Capacity charges of IPPs and Other External Sources (Mill Rs.)	21.582
Un-recovered cost of fuel in FCAs due to non-adjustment of T&D losses (Mill Rs.)	34.537
Revision of Fixed Cost of KANUPP	35.304
Payment of WPPF to IPPs (Tapal and GAEL)	144.153
Total Over-recovered Cost (Mill Rs.)	**496.953**
Estimated Units to be Sold Jan-Mar, 2014 (GWh)	2,393
Required Adjustments (Ps/kWh)	**20.766**

16. Variations in O&M Costs: The variations in O&M costs are worked out by comparing the monthly weighted average O&M costs of all external power sources. This method yields the results representing change both in prices and energy mix on month to month basis. As tabulated above, KESCL has claimed about Rs. 261 million variations on this account. The Authority noted that the main reason of claimed variation is the increase in the charges against the energy purchased from NTDC by KESCL in each month of the quarter.

17. Variations in Capacity Charges: Similar to the mechanism of O&M costs, the variation in Capacity Charges is worked out by comparing the monthly weighted average cost of all the power stations from which KESCL procures power, which represents change in both prices and energy. As shown above, KESCL has claimed around Rupees 22 million variation under this head. It was noted that the reason of the claimed variation is the increase in the Capacity Charges of the two IPPs (Tapal and Gul Ahmed) during the current quarter as compared to the reference month.

18. Un-recovered fuel cost due to non-adjustment of T&D losses in monthly FCA: The variation in the cost of fuel (own +power purchases) that were not allowed to KESCL to be passed on in the monthly FCAs to the extent of targeted T&D losses is required to be taken care of on quarterly basis. KESCL under this head has claimed about Rs. 35 million.

19. Revision of the Fixed Cost of KANUPP: As per the power purchase agreement signed between KESCL and KANUPP, the fixed cost component of the energy purchased from KANUPP is equal to the ***"yearly actual average fixed cost of the operating plants of KESCL (all old and new power plants) which is determined by the external auditor"***. KESCL, along with the current quarterly tariff adjustment request, submitted the statement of its cost of operating plants for the FY 2013 audited by RAHIM JAN & Co., Chartered Accountants and calculation of average fixed cost per unit sent out to be charged by KANUPP to KESCL during the FY 2014. As per the audited statement submitted by KESCL, the average fixed cost per unit sent out of all the operating plants of KESCL applicable in FY 2014 comes out to be Rs. 0.83622/kWh. The Authority noted that while allowing the quarterly tariff adjustments of the two quarters in the FY 2014 (Jul-Sep'13 and the current quarter), the average fixed cost per unit sent out, i.e. Rs. 0.687/kWh, which was applicable in the last year (FY 2013), was used hence KESCL has claimed an adjustment of difference to the tune of around Rs. 35 million under this head.

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20. Adjustment of WPPF Payment to IPPs: As per clause 14.2 of Power Purchase Agreement (PPA) signed between KESCL and Tapal & Gul Ahmed, WPPF and WWF are pass through items and have to be paid by KESCL under head of Supplementary Charges. KESCL under this head has claimed Rs. 144.153 million.

21. A comparative analysis of the adjustment in KESCL tariff for the un-recovered costs of the current quarter to be recovered as per request submitted by KESCL and being approved by the Authority after verification of all the relevant documentary evidence is tabulated below:

Description	Requested by KESCL	Approved
Variation in O&M Cost of IPPs and Other External Sources (Mill Rs.)	261.377	261.377
Variation in Capacity Charges of IPPs and Other External Sources (Mill Rs.)	21.582	21.582
Un-recovered Cost of fuel in FCAs due to non-adjustment of T&D losses (Mill Rs.)	34.537	(16.015)
Revision of Fixed Cost of KANUPP	35.304	35.304
Payment of WPPF to IPPs (Tapal and GAEL)	144.153	-
GIDC Adjustment of NTDC (Nov-13)	-	(75.307)
Adjustment of un-recovered cost of previous quarter	-	15.585
Total Over-recovered Cost (Mill Rs.)	**496.953**	**242.525**
Est. units to be sold @17% T&D losses in next quarter (Jan-Mar, 14) GWh	2,393	2,554.924
Required Adjustment in KESCL's tariff (Ps/kWh)	**20.766**	**9.492**

22. The difference in the requested and worked out variation in un-recovered fuel cost, due to non-adjustment of T&D losses, is mainly due to the reason that KESCL while claiming variation on this account used fuel cost component as invoiced by NTDC in each month of the quarter, whereas the aforementioned variation has been approved by the Authority on the basis of Authority's approved fuel cost component of NTDC.

23. KESCL in its request has claimed Rs. 144.153 million as the adjustment of WPPF Payment to IPPs (Gul Ahmed and Tapal). The Authority noted that KESCL had also claimed the mentioned costs in the previous quarterly tariff adjustments requests; however, the Authority did not allow them on the basis that such costs, as per the respective PPAs, are required to be passed on through supplemental charges for which there is no provision under the current adjustment mechanism. In accordance with its earlier decision, this particular cost claim has been disregarded by the Authority.

24. On verification of the energy invoice of NTDC for the month of December, 2013, it was found that NTDC made an adjustment of around minus Rs. 75 million with respect to Gas Infrastructure Development Cess (GIDC). KESCL while claiming December, 2013 monthly FCA, deducted that amount from the NTDC's invoiced fuel cost. Since the monthly variations are worked out on the basis of the Authority's approved fuel cost component of NTDC, therefore, the Authority has taken into account the aforementioned adjustment in the current quarter's adjustment rather than in the FCA for the month of December, 2013.

25. It has been noticed that while allowing recovery of unrecovered cost for the quarter July-September, 2013, the figure of units sent out rather than units sold was used owing to which KESCL could not recover Rs. 15.585 million which has been adjusted in the unrecovered cost portion of the current quarter.

26. Further, KESCL in its request estimated that 2393 GWh units will be sold @ 17% T&D losses in the next quarter (January-March, 2014), however as KESCL's quarterly request for the quarter of January-March, 2014 has been received, therefore,

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actual units sold figure @ 17% T&D losses for the quarter January-March, 2014, i.e. 2,554.924 GWh has been used to calculate the unrecovered cost in Ps/kWh.

27. The variation in tariff under this head, will be applicable for the next quarter only i.e. January-March, 2014 and will cease automatically at the end of that quarter.

c) **Reversal of tariff adjustment which was applicable for the current quarter only**

28. The Authority in its previous quarterly adjustment pertaining to July to September, 2013 allowed Ps. 2.523/kWh increase in KESCL's tariff for adjustment of un-recovered amount of Rs. 91.674 million by KESCL. As per the direction in the same decision, this increase of Ps. 2.523/kWh is required to be adjusted back in the KESCL's current quarterly adjustment in order to nullify its impact in the schedule of tariff. KESCL in its request claimed that Ps. 3.079/kWh be adjusted on this account as the decision for the quarter July-September, 2013 had not been issued by the Authority till the date of filing of request for the current quarter by KESCL.

Overall Adjustment in Tariff on account of Quarterly Adjustment

29. The overall cumulative variation in the KESCL's tariff after making the quarterly adjustment as discussed in the preceding paragraphs works out to be Ps. 19.375/kWh against the claimed figure of Ps. 35.018/kWh as detailed below:

	Paisas per kWh
• Changing the reference tariff from September, 2013 to December, 2013	12.406
• Unrecovered costs for the current quarter	9.492
• Reversal of tariff adjustment, which was applicable for the current quarter only	(2.523)
Total	**19.375**

Impact of error corrected through decision

30. The Authority corrected an inadvertent error in the Schedules of Tariff of KESCL through decision of the Authority dated March 31, 2014. However, KESCL has filed civil suit in high court of Sindh at Karachi against the decision of the Authority and the honorable court has suspended the decision of the Authority to the extent of reductions made by the Authority. Therefore, in compliance with the interim orders of the honorable court, the current quarterly adjustment has been worked out after excluding the impact of reductions made by the Authority through decision dated March 31, 2014. The impact of error and its adjustment shall be considered and worked out in the light of the decision of honorable court.

Claw Back Mechanism - Sharing of a portion of KESCL's profit with consumers

31. As per Authority's determination dated December 23, 2009, notified in the official Gazette of Pakistan vide S.R.O. No. 11(I)/2010 dated January 01, 2010 (hereinafter referred to as the "determination"), a Multi Year Tariff was awarded to KESCL which was a performance based tariff wherein separate component of investment and return was not allowed to KESCL. As per spirit of the Multi Year Tariff, certain efficiency parameters such as heat rates, transmission and

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distribution losses etc. were specified by the Authority thereby giving an incentive to the investor not to adjust the tariff downward if it brings more efficiency. Similarly, if performance falls short of the specified parameters then loss will be borne by the utility as no upward adjustment in tariff will be allowed.

32. The determination also prescribed the claw-back mechanism for sharing of KESCL's profits with the consumers (hereinafter referred to as the "claw-back mechanism"). The claw back mechanism provided that to the extent that the annual real return on the regulatory asset base exceeds 12%, the surplus shall be shared with the consumers through a reduction in tariff. The claw back mechanism was prescribed after having input from all stakeholders by following the due process of law and same was also notified in the official gazette.

33. As per the notified claw back mechanism provided in the determination, KESCL was required to submit the proposed adjustment of tariff, arising out of the transfer of a portion of the profits of the preceding financial year to consumers. The sharing formula as provided in the claw back mechanism is reproduced as under;

"1. KESCL shall. on yearly basis and within the first week of January, submit the proposed adjustment of tariff arising out of the transfer of a portion of the profits of the preceding financial year to consumers according to the claw back formula as provided herein below along-with the basis of the calculations supported with the relevant audited financial statements:

CLAWBACK FORMULA

2. To the extent that the annual real return on the regulatory asset base** exceeds the limits prescribed hereunder, the surplus return shall be shared with consumers through a reduction in tariff, on the basis set out below;*

a) Where the real annual return exceeds 12% but remains within 15%

25% of the profit value in excess of 12% Return on Assets ("ROA") will be transferred to the consumers

b) Where the real annual return exceeds 15% but remains within 18%

In addition to (a) above, 50% of the profit value in excess of 15% ROA will be transferred to the consumers

c) Where the real annual return exceeds 18%

In addition to (a) plus (b) above, 75% of the profit value in excess of 18% ROA will be transferred to the consumers.

** The annual return on the regulatory asset base shall be the audited earnings before interest and tax for that year divided by the average of the opening and closing regulatory asset base for that year.*

*** The regulatory asset base shall be the audited share capital and reserves plus bank and other borrowings less cash and securities.*

3. The decrease in average sale rate ($\triangle S_{1CB}$) will be calculated as under.-

$$(\triangle S_{1CB}) = \frac{Ps}{U_{ST}}$$

Where Ps = The aggregate profit to be transferred to the consumers calculated according to sub paras (a), (b) and (c) of para 2 above.

U_{ST} = Estimated units expected to be sold during the twelve months commencing from January 1st of the financial year following the year for which profits are calculated.

The above reduction shall be applied uniformly to all consumer classes".

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Claw Back for the Financial Year 2011-12

34. The Authority noted that KESCL was reporting losses since the determination, therefore claw back mechanism never became applicable in the past. The Authority also found that for the financial year 2011-12, KESCL reported an operating profit of Rs.10,270.976 million. The Authority considered that this profit might invoke the application of claw back mechanism. Though, as per the mechanism, it was the obligation of KESCL to submit the proposed adjustment of tariff to transfer a portion of profits of the preceding financial year to consumers, however, the Authority directed KESCL vide letter no. NEPRA/TRF-133/KESCL-2009/7066-67 dated September 06, 2012 to inform the Authority, supported with detailed working, that whether or not the reported profit qualifies the criteria for application of the claw back mechanism.

35. KESCL after seeking additional time for responding, vide letter no. KESC/C&A /NEPRA/2012/1026 dated October 15, 2012 submitted its calculations for consideration of the Authority. According to the calculations submitted by KESCL its annual return on regulatory asset base was 3.08%. KESCL submitted that:

i. Its annual return is less than the threshold defined in the determination, therefore claw back mechanism was not applicable for the financial year 2011-12.

ii. Its current submissions were without prejudice to its requests regarding suspension/removal of claw back mechanism in petitions filed with the Authority in 2009 and 2010.

iii. The current tariff regime is essentially a performance based tariff which dictates that the end consumer should benefit from any improvements in the company's efficiency. A profit sharing mechanism is effectively built into the tariff regime through yearly targets of transmission and distribution losses as determined by the Authority, which decline each year and thereby directly benefit the end consumer through a lower tariff. Performance targets assumed in the transmission and distribution losses curve are used to calculate any adjustment made to the consumer end tariff and are applicable independent of whether the company actually realizes the determined level of losses. This suggests that performance based profit sharing is in effect guaranteed by the current tariff adjustment mechanism. Application of claw back mechanism in combination with a performance based transmission and distribution loss schedule (assumed in tariff) equates to a double dip on the company's earning capability. There is no global precedent for a built in claw back mechanism in a performance based tariff structure, therefore, application of the claw-back mechanism actually serves as a penalty on the company with the revenue being capped through the implied transmission and distribution loss schedule built into the tariff and hampers the ability of the company to generate cash and reinvest in its operations.

iv. Under normal operating circumstances, profits earned by a company are typically re-invested in the business, which allow the business to sustainably finance any major and minor capital expenditure. If the company is able to achieve a successful turnaround and able to generate returns over the above mentioned bench marks, the company should have the option to reinvest that income into its generation, transmission and distribution assets. This approach not only allows to achieve sustainable operations in the long-term, but also allows the company to further strengthen and enhance the network to ensure smooth supply of power. KESCL must be able to generate funds internally to fund its operations and capital expenditures plans for which external funding is not viable.

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v. Continuation of the claw back mechanism will have several financial repercussions for the company in the future as it limits internal cash generation capability and effects its long term viability. The company will not be able to sustain long-term investment plans unless it is allowed to retain and invest surplus cash. Furthermore, the company will not be able to convince either shareholders or lenders to inject additional funding in the short term. If this double dip remains effective it is unlikely that shareholders will invest additional amounts beyond the US $ 361 million already injected which was committed under the Amended Agreement to the Implementation Agreement.

36. In addition to the above points, KESCL also requested the Authority to suspend the claw back mechanism for the period of the determination or defer it until such time at which KESCL is able to recover its accumulated losses.

37. The Authority considered relevant clauses of the determination and submissions of KESCL in detail. The Authority noted that claw back mechanism was a part of the tariff determination dated September 10, 2002, which became applicable at the time of KESCL's privatization. The Authority found that the issue of suspension/removal of claw-back mechanism has already been settled in the determination, after discussion and deliberation at length. Further, the Authority in its decision dated October 15, 2010 on the motion for leave for review filed by KESCL has also deliberated on this issue and has decided not to change the determination on this issue. The Authority therefore considers that submissions of KESCL regarding removal or non-application of claw back mechanism have no relevance and do not merit consideration at this stage.

38. The Authority found that calculations of annual return on regulatory asset base submitted by KESCL were not correct. The Authority assessed that financial results for the financial year 2011-12 activated the applicability of claw back mechanism. The Authority vide letter no. NEPRA/R/TRF-133/11690 dated September 26, 2013 shared the provisional workings as prepared by the Authority with KESCL for feedback and comments, if any.

39. KESCL vide letter no. KESC/C&A/NEPRA/2013/1202 dated October 07, 2013 reiterated that calculations earlier submitted by it were in accordance with the mechanism as defined in the determination and accordingly claw back was not applicable for the financial year 2011-12. KESCL also submitted following in respect of the provisional workings prepared by the Authority:

i. Surplus on revaluation of assets is defined as reserves under regulatory accounts as prescribed by the Authority for uniform system of accounts, issued vide SRO 1158(1)/2009 dated August 25, 2009, which is in compliance with the approved International Accounting Standards and International Framework Reporting Standards as applicable in Pakistan. This needs to be included while calculating the regulatory assets base.

ii. Other borrowings includes long term deposits, trade and other payables, accrued markup and short term deposits. The Authority should include these other borrowings while determining regulatory assets base for applicability of claw back.

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iii. Under the current claw back formula as defined in the determination, accumulated losses should not be added to the reserves as this reduces the capital base and does not reflect the assets base on which return has to be calculated. Considering accumulated losses in the claw back formula would also make the formula inconsistent with other power generation and distribution companies in the country where return has been calculated on net fixed asset. If the same formula which is applicable for other DISCOs in the country is made applicable, then the working of regulatory assets based on KESCL financial year 2011-12 balance sheet would be:

	Rupees in millions
Written down value of fixed assets	169,050
Less: deferred revenue	16,103
Net fixed assets (regulatory assets)	152,947

Regulatory assets as calculated by the Authority in its provisional working for financial year 2011-12 with accumulated losses is Rs. 92,866 million. Thus, from the above analysis and comparing both, it is clearly evident that accumulated losses should not be included.

iv. Derivative financial assets should not be included in cash and other securities as these do not form part of cash and cash equivalent as per International Accounting Standard – 7 (Statement of Cash Flow).

40. The Authority vide letter no. NEPRA/R/TRF-133/13060 dated November 26, 2013 communicated to KESCL that a careful review of provisional workings, communicated to KESCL, was done in the light of their comments and it transpired that impact of depreciation on incremental amount due to revaluation of assets was erroneously accounted for in the provisional working sent to KESCL. The Authority forwarded the revised provisional working after deleting the impact of depreciation on incremental amount due to revaluation of assets to KESCL for submission of its comments, if any.

41. KESCL in response to the aforesaid letter, vide letter no. KESC/C&A/NEPRA/2013/1252 dated December 03, 2013 reiterated its earlier submissions on this issue.

42. The Authority for the purpose of reaching at an informed decision, considered it just and appropriate to provide an opportunity of hearing to KESCL. Accordingly a hearing on the subject matter was held on January 21, 2014 at Islamabad which was attended by KESCL representatives.

43. The Authority considered and analyzed the submissions of KE in the light of claw back mechanism and noted that:

i. The Companies Ordinance 1984 does not consider surplus on revaluation of fixed assets as a reserve. In compliance with the requirements of Companies Ordinance 1984, KESCL has not classified surplus on revaluation of property, plant and machinery as a reserve in its audited financial statements. The Authority also noted that the Companies Ordinance, 1984 overrides the provisions of International Accounting Standards and International Framework Reporting Standards.

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NEPRA AUTHORITY

The Authority also found that schedules to National Electric Power Regulatory Authority (Uniform System of Accounts) Rules, 2009 neither define regulatory asset base nor are relevant for the purpose of claw back mechanism. The claw back mechanism clearly defines that regulatory asset base shall be the audited share capital and reserve, which in the case of KESCL does not include surplus on revaluation of property, plant and machinery.

The Authority also observed that surplus on revaluation of fixed assets is based on the valuers' estimates and its financial impacts are generally not considered while determining tariffs. In view of the aforesaid the Authority has decided not to include surplus on revaluation of fixed assets as a part of regulatory asset base.

ii. Claw back mechanism requires consideration of audited earnings before interest and tax. The Authority however noted that for the purposes of consistency of treatment, depreciation charged on incremental amount as a result of revaluation of property, plant and machinery needs to be added back to audited earnings before interest and tax. The Authority also noted that KESCL has not specifically objected to this treatment proposed by the Authority in provisional workings communicated to it.

iii. Bank and other borrowings as stated in the claw mechanism means borrowings from banks and other sources such as from International Finance Corporation, Modarabas, KESC AZM certificates, etc. The Authority noted that long term financing of KESCL as per its audited financial statements includes financing from GoP, Gul Ahmed Energy Limited, Karachi Nuclear Power Plant, BYCO Petroleum Pakistan Limited, National Transmission and Dispatch Company, etc. The Authority after due consideration has decided to consider long term financing, current maturity of long term financing and short term borrowings, as disclosed in the audited financial statements of KESCL, in the computation of regulatory asset base. The Authority considers that deposits, trade and other payables and accrued mark-up do not fall in the definition of bank and other borrowings for the computation of profit to be clawed back.

iv. The Authority noted that accumulated losses are reserves and have been classified as such in the audited financial statements of KESCL. The claw back mechanism clearly defines that regulatory asset base shall be the audited share capital and reserves, so accumulated losses need to be considered in the computation of regulatory asset base. The Authority further noted that claw back mechanism of KESCL is not comparable to DISCO's and this claw back mechanism which is being applied now was known to all the stake holders at the time of KESCL privatization.

v. The Authority observed that according to the audited financial statements of KESCL derivative financial assets are cash flow hedges. The Authority considers derivative financial assets to be securities and noted that International Accounting Standard 7 quoted by KESCL is not relevant for the purpose of claw back mechanism. The Authority in accordance with the stipulation of claw back mechanism has considered derivative financial assets as a part of cash and securities.

44. In view of the foregoing, the Authority has decided that provisional workings forwarded to KESCL vide letter no. NEPRA/R/TRF-133/13060 dated November 26, 2013 need not any change and Rs.889.917 million are due for claw back. Detailed calculations of the amount clawed back are attached as **Annexure-I**.

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45. As per the mechanism provided in the determination, the decrease in average sale rate is to be calculated on the basis of estimated units expected to be sold during the twelve months period commencing from January 1st of the Financial Year following the year for which profits are calculated, which in the instant case is from January 01, 2013 to December 31, 2013. However, since the said time period has lapsed, therefore, the Authority has decided to adjust the amount of claw back for Financial Year 2011-12 from January 01, 2014 to December 31, 2014. GoP, shall consider adjusting the tariff differential subsidy on account of markup/interest, if any, arising out of belated adjustment of the claw back amount for the Financial Year 2011-12.

46. The decrease in consumer class wise tariff on account of Claw Back Mechanism for Financial Year 2011-12, except for the life line consumers, based on units sold from January 01, 2014 to December 31, 2014 i.e. 13,081.44 GWh, rounded to two decimal places works out to **minus paisa 7/ kWh, for each of the four (04) quarters from January 01, 2014 to December 31, 2014**, which is hereby approved. Units sold include Actual Units sold from January to June 2014 and units expected to be sold from July to December 2014, based on Authority's approved target of T&D losses. Any over / under recovered amount will be adjusted subsequently.

Claw Back for the Financial Year 2012-13

47. The Authority noted that KESCL, in its Audited Financial Statements for the Financial Year 2012-13, has reported an operating profit of Rs.17,864.770 million. Though, as per the mechanism, it was the obligation of KESCL to submit the proposed adjustment of tariff to transfer a portion of profits of the preceding financial year to consumers, however it did not submit the adjustment request, therefore, the Authority directed KESCL vide letter no. NEPRA/TRF-133/KESC-2009/5760 dated June 4, 2014 to inform the Authority, supported with detailed working, that whether or not the reported profit qualifies the criteria for application of the claw back mechanism.

48. KESCL vide its letter No.KE/C&A/NEPRA/2014/206 dated June 18, 2014 submitted its calculations for consideration of the Authority. According to the calculations submitted by KESCL, its annual return on regulatory asset base was 5.13%. KESCL submitted that its annual return is less than the threshold defined in the determination, therefore claw back mechanism was not applicable for the financial year 2012-13. KESCL also reiterated that the entire contents of its letters dated October 15, 2012 and October 7, 2013 (related with Claw Back calculations for FY 2011-12), form an integral part of this letter, as if they were duly repeated herein, with regard to the said mechanism.

49. The Authority found that calculations of annual return on regulatory asset base submitted by KESCL were not correct. The Authority noted that calculations were carried out by KESCL on the very same basis as were done by it in Financial Year 2011-12. The Authority observed that all the issues raised by KESCL in its letters dated October 15, 2012 and October 7, 2013 have already been addressed by the Authority in its decision in the matter of transfer of a portion of profit of KESCL for the financial year 2011-12 to the consumers.

50. The Authority assessed that financial results of KESCL for the financial year 2012-13 activated the applicability of claw back mechanism and an amount of Rs.4,522.996 million is due for claw back for financial year 2012-13. Detailed calculations of the amount clawed back are attached as **Annexure-II**.

51. As per the mechanism provided in the determination, the decrease in average sale rate is to be calculated on the basis of estimated units expected to be sold during the twelve months period commencing from January 1st of the Financial Year following the year for which profits are calculated, which in the instant case is from January 01, 2014 to December 31, 2014.

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52. Accordingly, the decrease in consumer class wise tariff, on account of claw back mechanism for Financial Year 2012-13, except for the life line consumers, based on units sold from January 01, 2014 to December 31, 2014 i.e. 13,081.44 GWh, rounded to two decimal places works out to **minus paisa 35/ kWh, for each of the four (04) quarters from January 01, 2014 to December 31, 2014,** which is hereby approved. Units sold include Actual Units sold from January to June 2014 and units expected to be sold from July to December 2014, based on Authority's approved target of T&D losses. Any over / under recovered amount will be adjusted subsequently.

53. In order to allow adjustment in KESCL's tariff for the aforesaid cost variations for the current quarter and on account of claw back amounts for Financial Year 2011-12 and 2012-13, **KESCL is allowed a uniform decrease in consumer end tariff for all consumer categories, except for the life-line consumers, by minus paisa 22 per kWh.**

54. In view of the foregoing, the revised schedule of tariff for the subject quarter to be applicable from January 01, 2014 to March 31, 2014 is attached herewith as **Annexure-III.** The applicability period of the schedule of tariff issued vide Authority's decision No. NEPRA/TRF-133/KESC-2009/3173-3176 dated March 31, 2014, for the quarter July to September 2013 needs to be changed and the same will be done upon final decision of the Sindh High Court.

55. The revised schedule of tariff has been prepared after excluding the impact of reductions made by the Authority through its decision dated March 31, 2014. Since the time of recovery as specified above has lapsed, therefore, KESCL is hereby allowed to adjust the bills of pertinent consumers as per the following schedule;

Adjustment for the Month of	To be Charged in the Monthly Bills of
January, 2014	November, 2014
February, 2014	December, 2014
March, 2014	January, 2015

AUTHORITY

13.10.14

(Khawaja Muhammad Naeem)
Member

14/10/14

(Maj (R) Haroon Rashid)
Member

14.10.14

(Himayat Ullah Khan)
Member

15/10/2014

(Habibullah Khilji)
Vice Chairman

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14/10

National Electric Power Regulatory Authority (NEPRA)

Calculation of Claw Back for sharing with the consumers

ANNEX-I

	(Rupees in '000)		
	2012	2011	**Average**
Audited Share capital	92,957,949	80,335,490	86,646,720
Audited reserves			
Capital Reserves	509,172	509,172	509,172
Revenue Reserves	5,372,356	5,372,356	5,372,356
Accumulated Losses	(82,854,799)	(87,332,960)	(85,093,880)
Other Reserves	(621,373)	(1,333,346)	(977,360)
Total Reserves	(77,594,644)	(82,784,778)	(80,189,711)
Total Equity	***15,363,305***	***(2,449,288)***	***6,457,009***
Bank and other borrowings			
Long term Financing	43,183,473	47,157,037	45,170,255
Current Maturity	14,217,317	10,495,678	12,356,498
Short term Borrowings	23,420,575	21,374,141	22,397,358
Total Borrowings	***80,821,365***	***79,026,856***	***79,924,111***
	96,184,670	***76,577,568***	***86,381,119***
Less: Cash and Other Securities			
Cash and Bank balances	1,183,765	1,268,670	1,226,218
Derivative Financial Assets	2,135,048	36,534	1,085,791
	3,318,813	***1,305,204***	***2,312,009***
Regulatory Assets Base	***92,865,857***	***75,272,364***	***84,069,111***

12% of Regulatory Assets	**<A>**	***10,088,293***
15% of Assets	**<B>**	***12,610,367***
18% of Assets	**<C>**	***15,132,440***
Earning before Interest and Tax - Gross of Depreciation on Revaluation	**<D>**	***13,129,164***

			@	
Annual Return from 12% -15% of Regulatory assets to be shared @ 25%	**<B-A>**	***2,522,073***	**25%**	***630,518***
Annual Return from 15% - 18% of Regulatory assets to be shared @ 50%	**<D-B>**	***518,797***	**50%**	***259,399***
Annual Return above 18 % of Regulatory assets to be shared @ 75%		-	**75%**	-

Amount of claw back - to be transferred to consumers **889,917**

<D>

Computation of Earning before Interest and Tax - gross of Depreciation on Revaluation

	Rs. '000
Audited Earnings before Interest and Tax as per Audited Accounts 2011-12	10,270,976
Add: Depreciation on Revalued assets	2,858,188
	13,129,164.00

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National Electric Power Regulatory Authority (NEPRA) **ANNEX-II**

Calculation of Claw Back for sharing with the consumers

	2013	2012		Average
	(Rupees in '000)			
Audited Share capital	96,261,551	92,957,949		94,609,750
Audited reserves				
Capital Reserves	509,172	509,172		509,172
Share Premium	1,500,000	-		750,000
Revenue Reserves	5,372,356	5,372,356		5,372,356
Accumulated Losses	(74,267,606)	(82,854,799)		(78,561,203)
Other Reserves	(490,460)	(621,373)		(555,917)
Total Reserves	(67,376,538)	(77,594,644)		(72,485,591)
Total Equity	***28,885,013***	***15,363,305***		***22,124,159***
Bank and other borrowings				
Long term Financing	24,901,343	43,183,473		34,042,408
Current Maturity	14,965,034	14,217,317		14,591,176
Short term Borrowings	37,608,485	23,420,575		30,514,530
Total Borrowings	***77,474,862***	***80,821,365***		***79,148,114***
	106,359,875	***96,184,670***		***101,272,273***
Less: Cash and Other Securities				
Cash and Bank balances	790,396	1,183,765		987,081
Derivative Financial Assets	2,523,006	2,135,048		2,329,027
	3,313,402	***3,318,813***		***3,316,108***
Regulatory Assets Base	***103,046,473***	***92,865,857***		***97,956,165***
12% of Regulatory Assets			<A>	***11,754,740***
15% of Assets			<B>	***14,693,425***
18% of Assets			<C>	***17,632,110***
Earning before Interest and Tax - Gross of Depreciation on Revaluation			<D>	***20,724,086***

			@	
Annual Return from 12% -15% of Regulatory assets to be shared @ 25%	<B-A>	***2,938,685***	25%	***734,671***
Annual Return from 15% - 18% of Regulatory assets to be shared @ 50%	<C-B>	***2,938,685***	50%	***1,469,342***
Annual Return above 18 % of Regulatory assets to be shared @ 75%	<D-C>	***3,091,976***	75%	***2,318,982***
Amount of claw back - to be transferred to consumers				**4,522,996**

<D>

Computation of Earning before Interest and Tax - gross of Depreciation on Revaluation

	Rs. '000
Audited Earnings before Interest and Tax as per Audited Accounts 2012-13	17,864,770
Add: Depreciation on Revalued assets	2,859,316
	20,724,086

Annexure-III

REVISED SCHEDULE OF ELECTRICITY TARIFF
FOR KARACHI ELECTRIC SUPPLY COMPANY LIMITED (KESCL)
DETERMINED FOR THE QUARTER OCTOBER'13-DECEMBER'13

A-1 GENERAL SUPPLY TARIFF - RESIDENTIAL

Sr. No.	TARIFF CATEGORY / PARTICULARS	FIXED CHARGES Rs/kW/M	VARIABLE CHARGES Rs/kWh	
a)	For Sanctioned load less than 5 kW			
i	Up to 50 Units	-		4.00
	For Consumption exceeding 50 Units			
ii	1- 100 Units	-		14.52
iii	101- 200 Units	-		15.56
iv	201- 300 Units	-		16.29
v	301- 700 Units	-		18.38
vi	Above 700 Units	-		20.26
b)	For Sanctioned load 5 kW & above			
			Peak	Off-Peak
	Time Of Use	-	21.26	15.26

Under tariff A-1, there shall be minimum monthly customer charge at the following rates even if no energy is consumed.

a) Single Phase Connections: Rs. 75/- per consumer per month
b) Three Phase Connections: Rs. 150/- per consumer per month

A-2 GENERAL SUPPLY TARIFF - COMMERCIAL

Sr. No.	TARIFF CATEGORY / PARTICULARS	FIXED CHARGES Rs/kW/M	VARIABLE CHARGES Rs/kWh	
a)	For Sanctioned load less than 5 kW			20.76
b)	For Sanctioned load 5 kW & above	400.00		17.96
			Peak	Off-Peak
c)	Time Of Use	400.00	22.26	16.76

Under tariff A-2, there shall be minimum monthly charges at the following rates even if no energy is consumed.

a) Single Phase Connections; Rs. 175/- per consumer per month
b) Three Phase Connections: Rs. 350/- per consumer per month

B INDUSTRIAL SUPPLY TARIFFS

Sr. No.	TARIFF CATEGORY / PARTICULARS	FIXED CHARGES Rs/kW/M	VARIABLE CHARGES Rs/kWh	
B1	Less than 5 kW (at 400/230 Volts)	-		17.26
B2(a)	5-500 kW (at 400 Volts)	400.00		15.86
B3(a)	For all loads upto 5000 KW (at 11,33 kV)	380.00		15.46
B4(a)	For all loads upto 5000 KW (at 66,132 kV)	360.00		15.06
	Time Of Use		Peak	Off-Peak
B2(b)	5-500 kW (at 400 Volts)	400.00	21.26	15.01
B3(b)	For All Loads up to 5000 kW (at 11,33 kV)	380.00	20.76	14.51
B4(b)	For All Loads (at 66,132 kV & above)	360.00	20.26	14.26
B5	For All Loads (at 220 kV & above)	340.00	19.76	14.01

For B1 consumers there shall be a fixed minimum charge of Rs. 350 per month.
For B2 consumers there shall be a fixed minimum charge of Rs. 2,000 per month.
For B3 consumers there shall be a fixed minimum charge of Rs. 50,000 per month.
For B4 consumers there shall be a fixed minimum charge of Rs. 500,000 per month.

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For B5 consumers there shall be a fixed minimum charge of Rs. 1000,000 per month.

C - SINGLE-POINT SUPPLY FOR PURCHASE IN BULK BY A DISTRIBUTION LICENSEE AND MIXED

Sr. No.	TARIFF CATEGORY / PARTICULARS	FIXED CHARGES Rs/kW/M	VARIABLE CHARGES Rs/kWh	
C -1	For supply at 400/230 Volts			
a)	Sanctioned load less than 5 kW	-		17.26
b)	Sanctioned load 5 kW & up to 500 kW	400.00		16.41
C -2(a)	For supply at 11,33 kV up to and including 5000 kW	380.00		16.41
C -3(a)	For supply at 132 and above, up to and including	360.00		16.26
	Time Of Use		Peak	Off-Peak
C -1(c)	For supply at 400/230 Volts 5 kW & up to 500 kW	400.00	21.26	15.26
C -2(b)	For supply at 11,33 kV up to and including 5000 kW	380.00	20.76	14.46
C -3(b)	For supply at 132 kV up to and including 5000 kW	360.00	20.26	14.26

D - AGRICULTURE TARIFF

Sr. No.	TARIFF CATEGORY / PARTICULARS	FIXED CHARGES Rs/kW/M	VARIABLE CHARGES Rs/kWh	
D-1	For all Loads	200.00		16.74
	Time of Use		Peak	Off-Peak
D-2	For all Loads	200.00	22.86	14.86

Note:- The consumers having sanctioned load less than 5 kW can opt for TOU metering.

E - TEMPORARY SUPPLY TARIFFS

Sr. No.	TARIFF CATEGORY / PARTICULARS	FIXED CHARGES Rs/kW/M	VARIABLE CHARGES Rs/kWh
E-1(i)	Residential Supply	-	20.66
E-1(ii)	Commercial Supply	-	23.56
E-2 (i)	Industrial Supply	-	20.26
E-2 (ii)	Bulk Supply		
	(a) at 400 Volts	-	20.66
	(b) at 11 kV		20.26

For the categories of E-1(i&ii) and E-2 (I&ii) above, the minimum bill of the consumers shall be Rs. 50/- per day subject to a

F - SEASONAL INDUSTRIAL SUPPLY TARIFF

125% of relevant industrial tariff

Note:

Tariff-F consumers will have the option to convert to Regular Tariff and vice versa. This option can be

G- PUBLIC LIGHTING

Sr. No.	TARIFF CATEGORY / PARTICULARS	FIXED CHARGES Rs/kW/M	VARIABLE CHARGES Rs/kWh
	Street Lighting	-	20.26

Under Tariff G, there shall be a minimum monthly charge of Rs.500/- per month per kW of lamp capacity installed.

H - RESIDENTIAL COLONIES ATTACHED TO INDUSTRIAL PREMISES

Sr. No.	TARIFF CATEGORY / PARTICULARS	FIXED CHARGES Rs/kW/M	VARIABLE CHARGES Rs/kWh
	Residential Colonies attached to industrial premises	-	18.26

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