



Registrar

National Electric Power Regulatory Authority Islamic Republic of Pakistan

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

No. NEPRA/TRF-133/KESC-2009/16882-16885
November 1, 2018

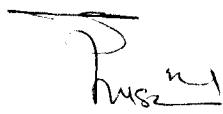
Subject:- **Decision of the Authority in the matter of K-Electric Limited Request for Quarterly Adjustment in its Tariff for the Quarter ended June 2016**

Dear Sir,

Please find enclosed herewith the subject decision of the Authority (07 pages) in respect of K-Electric 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 in the official gazette pursuant to Section 31(7) of the Regulation of Generation, Transmission and Distribution of Electric Power Act, 1997.

Enclosure: As above


21 11 18
(Syed Safer Hussain)

Secretary,
Ministry of Energy (Power Division),
'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, Government of Pakistan
5-A, EDB Building, Constitution Avenue, Islamabad



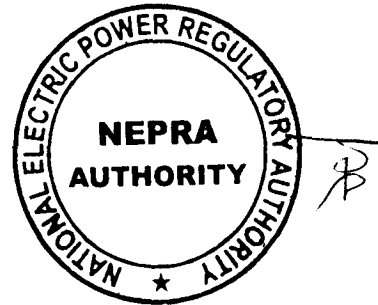
DECISION OF THE AUTHORITY IN THE MATTER OF K-ELECTRIC LIMITED REQUEST FOR QUARTERLY ADJUSTMENT IN ITS TARIFF FOR THE QUARTER ENDED JUNE, 2016

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) dated December 23, 2009 notified vide S.R.O. No. 11(I)/2010 dated January 01, 2010, K-Electric Limited (hereinafter referred to as "K-Electric", "the company" or "the utility") has been allowed certain adjustments in its tariff on quarterly basis which include the following:
 - Impact of variation in the capacity charges and Operation and Maintenance (hereinafter referred to as the "O&M") components of the cost of power purchased by K-Electric from the external sources.
 - Impact of target Transmission and Distribution losses @15% (hereinafter referred to as the "T & D losses") not allowed in the monthly Fuel Charges Adjustments (hereinafter referred to as "FCA").
2. In addition to the aforesaid adjustments in tariff, for allowing K-Electric to recover its tariff in future on the latest prices, the tariff level is required to be adjusted at the price level of last month of the quarter i.e. in the current case the price level of June, 2016.

CURRENT REQUEST

3. K-Electric, in accordance with the prescribed mechanism for adjustment of fuel cost and power purchase cost variation, submitted quarterly adjustment request for the quarter April-June, 2016 dated July 26, 2016 (hereinafter referred to as the "current quarter/instant quarter").
4. K-Electric also submitted that its Integrated Multi Year Tariff Petition (I-MYT Petition) for the next control period is under process of approval. The new I-MYT Petition contains request for adjustments in O&M cost, X (efficiency) factor used in annual indexation of O&M costs and other requests; which will be effective from July 01, 2016. Accordingly, the adjustments effective from July 01, 2016, will be filed separately after determination of I-MYT petition for the next control period.



[Handwritten signature]

[Handwritten signature]



5. The summary of the adjustment as requested by K-Electric is tabulated below:

Items	Description	Proposed Adjustment
	Fuel Price Variation of June, 2016 over March, 2016 (Ps/kWh)	57.137
	Power Purchase Price Variation of June, 2016 over March, 2016 (Ps/kWh)	11.023
1	Total Variation in Tariff (Ps/kWh)	68.160
	Un Recovered Cost	
	Variation in O&M cost of IPPs and Other External Sources (Mill Rs)	(183.606)
	Variation in Capacity Charges of IPPs and Other External Sources (Mill Rs)	(33.917)
	Un-recovered cost of fuel in FCAs due to non-adjustment of T&D losses (Mill Rs)	52.733
	FCA not passed on to the consumers.	(98.416)
	Total Unrecovered Cost (Mill Rs.)	(263.206)
	Estimated Units to be Sold in the next quarter (GWH)	3,685.742
2	Required Adjustments (Ps/kWh)	(7.141)
3	Reversal of Unrecovered Cost of Previous Quarter (Ps/kWh)	(4.946)
	Total Required Adjustment in K-Electric's Tariff (Ps/kWh) (1+2+3)	56.073

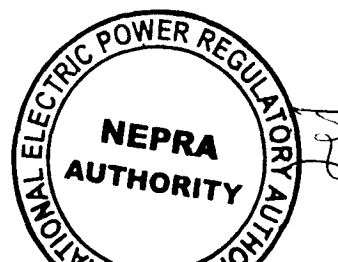
PUBLIC HEARING

6. Since the impact of the tariff adjustment affects the consumers directly, therefore, in order to make K-Electric's tariff adjustment process transparent, the Authority decided to provide an opportunity of hearing to the consumers as well as other stakeholders, for submission of their comments. Accordingly, a public hearing for consideration of the requested adjustment was conducted by the Authority on September 08, 2016 (Thursday) at 11:00 am at Marriot Hotel, Karachi; notice thereof was published in the daily newspapers on August 25, 2016. Further, notices were also sent to the major stakeholders, individually, thereby inviting their objections/ comments.

7. In response to the public notice as well as the individual notices to the stakeholders, comments in writing were received from Karachi Chamber of Commerce and Industries ("KCCI"). The same were forwarded to K-Electric for response. Those comments as well as the response of K-Electric is discussed as hereunder;

KCCI submitted that the auxiliary consumption of K-Electric's generation fleet is above the benchmark auxiliary consumption of 6.1%, set in Authority's determination dated December 23, 2009, which merits for an energy audit. The Authority observed that in the current Multi Year Tariff ("MYT") regime of K-Electric with a control period from July, 2009 to June, 2016, an auxiliary consumption benchmark of 6.1% was established for the whole fleet. As evident from the corresponding documentary evidence submitted by K-Electric along with its monthly and quarterly requests, the utility is underperforming i.e. its actual overall auxiliary consumption is higher compared to the benchmark set by NEPRA. However, the mechanism built in MYT is such that the impact of in-efficiency, if any, by K-Electric, has never been passed on to the consumers of K-Electric.

KCCI also submitted that NEPRA has allowed K-Electric to operate its power plants on higher heat rates, thereby contradicting its own rules and regulations. The Authority noted that in MYT determination dated December 23, 2009, K-Electric was directed to perform heat rate tests of upcoming power plants and submit the same to the Authority for approval. Accordingly, heat rate tests of Bin Qasim Power Station-II (BQPS-II), Korangi Combined Cycle Power Plant ("KCPP"), Korangi Gas-II ("KTGT-II") and Site Gas-II ("STGT-II") were carried out, however, the same resulted in efficiencies of the mentioned power plants on the lower side. The Authority keeping in view the interest of the consumers approved and allowed monthly and quarterly variations on basis of heat rates which are more efficient than heat rates





resulting after the aforementioned heat rate tests. It is also pertinent to mention here that fuel price variations on BQPS-II have never been allowed to K-Electric due to non-finalization of its heat rate test.

FINANCIAL ANALYSIS

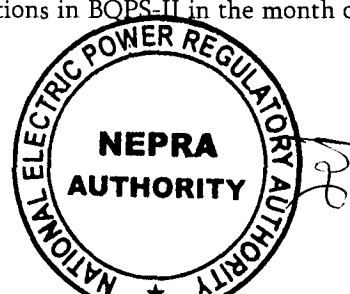
8. As per the prescribed mechanism, quarterly adjustment in K-Electric's tariff are made (i) to bring the reference tariff at the level of costs/prices of last month of any quarter and to adjust that in SOT, (ii) to allow the adjustment of under/over recovered cost during that quarter and (iii) to adjust back the impact of under/over recovered cost allowed during the previous quarter. The Authority has noted that that the control period of the MYT as specified in the determination of the Authority dated December 23, 2009 has expired on June 30, 2016. From July 01, 2016, SOT issued vide new determination shall be applicable. Therefore, the Authority is of view that there is no requirement of leveling up the tariff and issuing SOT with the instant quarterly adjustment. The only adjustment that needs to be made in this decision is the amount of over/under recovery during the quarter which can be adjusted in subsequent quarterly adjustment under the mechanism prescribed in new tariff.

Under/Over-Recovered Cost For The Current Quarter

9. As per the approved mechanism, the monthly variation on account of O&M cost and capacity charges components of the power purchase cost of K-Electric, accumulated and not allowed in the monthly adjustments, is required to be adjusted in the quarterly tariff adjustment of K-Electric. In addition, the cost of fuel that was not allowed to the utility 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 in accordance with the prescribed mechanism. Furthermore, costs that are allowed to be passed on under the approved mechanism but were not accounted for in the monthly FCAs are accounted for in the quarterly adjustment.
10. K-Electric has requested for the adjustment of minus 263.206 million under this head. A comparative analysis of the adjustment in K-Electric tariff for the under/over-recovered costs of the current quarter to be adjusted as per request submitted by K-Electric and being approved by the Authority after verification of the relevant documentary evidence is tabulated below;

DESCRIPTION	Requested by K-Electric	Approved
Variation in O&M cost of IPPs and Other External Sources (Mill Rs.)	(183.606)	(71.410)
Variation in Capacity Charges of IPPs and Other External Sources (Mill Rs.)	(33.917)	(33.917)
Un-recovered cost of fuel in FCAs due to non-adjustment of T&D losses (Mill Rs.)	52.337	30.740
Bonus payment made to Tapal (Mill Rs.)	-	14.069
FCA not charged to consumer categories for April, 2016	(98.416)	(98.370)
Total Unrecovered Cost (Mill Rs.)	(263.206)	(158.886)

11. The difference in the requested and worked out variation in O&M cost is due to the reason that K-Electric has not accounted for the O&M cost of Rs. 112 million in respect of the energy purchased from CPPA-G for the month of June, 2016 whereas the same has been included in the approved amount.
12. The reason of difference in the requested and worked out variation in un-recovered fuel cost due to non-adjustment of T&D losses is the inconsistency on part of K-Electric while calculating the price of furnace oil which is worked out by K-Electric using the moving average basis whereas the Authority has consistently been using monthly weighted average method to work out this rate. Further, K-Electric has also claimed the variations in BQPS-II in the month of June, 2016

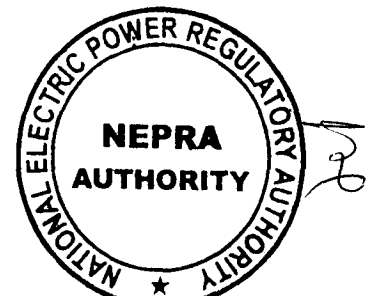


which have not been taken in to account due to non-finalization/approval of its heat rate. In power purchase cost, K-Electric has used invoiced component of CPPA-G while calculating the fuel price variations for the month of June, 2016, however, Authority's approved fuel component for XWDISCO's has been used in the approved amount.

13. Subsequent to submission of the quarterly adjustment request, a bonus payment invoice of Tapal worth Rs. 14.069 million was submitted by K-Electric with a request for consideration of the same in the workings of adjustment of tariff for the current quarter. The aforementioned request has been made by K-Electric on account of payment of Bonus to Tapal in line with Section 9.6, of Power Purchase Agreement ("PPA") signed between K-Electric and Tapal, which states that "In the event that the Net Electrical Output ("NEO") during any Agreement Year is in excess of 680,433,000 kWh, the KESCL shall pay to the Company within sixty (60) days of the end of such agreement year, in addition to any other payments due to the Company pursuant to Section 9.2, an amount equal to Rs. 0.08 for each kWh by which the NEO of the complex during the year is greater than 680,433,000 kWh. The amount of bonus payable pursuant to this Section 9.6 shall be adjusted from time to time in accordance with Schedule 6". The calculations of bonus payment invoice were checked by NEPRA professionals in light of relevant provisions of PPA, foreign exchange rates and US consumer price index rates available online and were found to be in order; hence, KE has been allowed the adjustment of bonus payment of Rs. 14.069 million in the tariff adjustments of the current quarter.
14. Ministry of Water and Power vide its policy guidelines, Section 31 (4) of the NEPRA Act, 1997 on 21.05.2015 stated that "Any negative adjustment on account of monthly FCA will not be passed on to the Domestic consumers who have subsidized electricity tariff." In pursuance of the aforementioned guidelines, the Authority vide its decision of K-Electric's FCA for the month of April, 2016 had directed the company not to pass on the impact of negative FCA to the life line consumers, agricultural consumers and the residential consumers using up to 300 units. As mentioned in the respective monthly FCA decisions, the impact of FCA for the month of April, 2016 is to be adjusted in Schedule of Tariff (hereinafter referred to as "SoT") of the current quarter. The information/working provided by K-Electric in this regard has been verified and an amount of minus Rs. 98.370 million is being adjusted in the unrecovered cost of K-Electric of the current quarter.
15. **In view of above discussions, K-Electric is hereby allowed the adjustment of minus Rs. 158.886 million for the quarter April-June, 2016, to be adjusted in the subsequent quarterly adjustment to be filed by K-Electric as per the new MYT.**

Claw Back for the FY 2015-16

16. 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, Multi Year Tariff awarded to K-Electric was a performance based tariff wherein separate component of investment and return was not allowed to K-Electric. As per spirit of the Multi Year Tariff, certain efficiency parameters such as heat rates, transmission and 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.
17. The determination also prescribed the clawback mechanism for sharing of K-Electric's profits with the consumers (hereinafter referred to as the "clawback mechanism"). The clawback 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.

18. 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 (ΔS_{ICB}) will be calculated as under.

$$(\Delta S_{ICB}) = \frac{P_s}{U_{ST}}$$

Where

P_s = 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".

19. The Authority noted that K-Electric, in its Audited Financial Statements for the Financial Year 2015-16, has reported an Earnings before Interest & Tax (EBIT) of Rs.31,001.241 million, which after including depreciation of Rs.5,963.165 million on revalued assets, works out as Rs. 36,964.406 million.

20. As per the mechanism, K-Electric is obligated to submit proposed adjustment of tariff for transfer of a portion of profits of the preceding financial year within the first week of January but at that time K-Electric was not able to finalize its annual accounts for the FY 2015-16, which were finalized in August 2017.





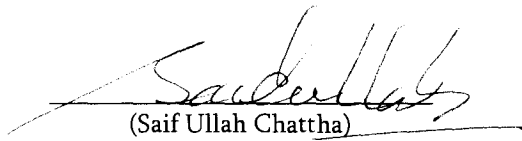
21. K-Electric, however, even after finalization of its financial statements for the FY 2015-16, did not submit the required adjustment request. The Authority, therefore, vide letter dated November 03, 2017, directed K-Electric to inform the Authority, supported with detailed workings, as to whether the reported profit for the FY 2015-16, qualifies the criteria for application of the claw back mechanism or otherwise.
22. K-Electric, vide letter dated November 23, 2017, provided its working of clawback amount for the FY 2015-16, whereby, it calculated an amount of Rs.1,218 million to be clawed back from profits for the FY 2015-16. K-Electric, *inter alia*, also stated that it had already submitted detailed response regarding clarification on claw back calculations for the FY 2015, supported by an independent opinion from accounting expert vide letter dated July 31, 2017 and that the matter of claw back relating to previous years is sub-judice in the Honorable Sindh High Court, wherein the key difference of interpretation is on the following two issues:
 - a) Inclusion of Surplus on Revaluation of Property, Plant and Equipment in RAB and
 - b) Exclusion of Accumulated losses from RAB.
23. KE also requested for a meeting with the Authority to present its arguments to resolve this long-standing issue in the best interest of stakeholders.
24. The Authority observed that calculations of annual return on regulatory assets submitted by K-Electric for FY 2015-16 were not correct. The Authority noted that calculations were carried out by K-Electric on the very same basis as were done by K-Electric for the Financial Year 2011-12, FY 2012-13, FY 2013-14 and FY 2014-15. The Authority also noted that the issues raised by K-Electric had already been addressed by the Authority in its earlier decisions in this regard and the decisions were issued after following due process of law i.e. by giving K-Electric an opportunity to explain its point of view in writing and through hearing as well.
25. Following the same principles, as done for the Financial Year 2011-12, FY 2012-13, FY 2013-14 & FY 2014-15, and strictly in accordance with the determined and the notified clawback of profits mechanism, the Authority noted that financial results of K-Electric for the financial year 2015-16 activated the applicability of clawback mechanism.
26. The Authority while analyzing the financial statements of K-Electric for the FY 2015-16, noted that K-Electric had adjusted its Revenue for the FY 2015-16, by an amount of Rs.8,096 million on account of profit clawback amount. This effectively resulted in lower EBIT for the FY 2015-16 and subsequently lower profit clawback amount, if worked out on the basis of reported EBIT of the FY 2015-16.
27. The Authority, keeping in view the submissions of K-Electric and the notified clawback mechanism, observed that clawback is applicable on the EBIT for the year and therefore calculating profit to be clawed back by reducing EBIT on account of profit claw back is not correct and against the spirit of approved profit claw back mechanism. Thus, working out profit to be clawed back by K-Electric by reducing its revenue reported for the year, with the amount of profit to be shared with the consumers, results in lower assessment of profit claw back amount.
28. Accordingly, for the FY 2015-16, the Authority has recalculated the EBIT, by adding back amount of Rs.8,096 million (*deducted by K-Electric from its Revenue on account of profit clawback*) and incremental depreciation due to revaluation of assets of Rs.5,963.165 million, in the reported EBIT for the FY 2015-16, thus, resulting in revised EBIT of Rs.45,060.406 million. Consequently, the amount of profit clawback for the FY 2015-16 has been worked out as Rs.16,541.58 million based on average RAB of Rs.153,366.42 million. The average RAB has been worked out based on the Audited Financial Statements for the FY 2014-15 (*as per NEPRA's working with respect to previous claw back decisions*) and for the FY 2015-16, the RAB has been worked out by adding back the amount of Rs.8,096 million (*deducted by K-Electric from its Revenue on account of profit claw back*). Further, the amount of Rs. 3,158 million regarding non-current assets held for sale, has also been included while working out the amount of cash and securities.





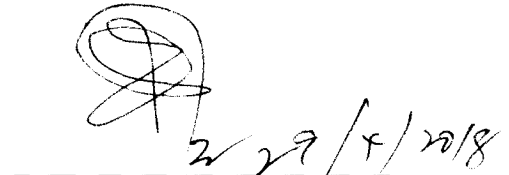
29. As per the mechanism provided in the MYT determination dated December 23, 2009, the decrease in average sale rate due to profits claw back is to be calculated on the basis of estimated units expected to be sold during the twelve months period commencing from January 1st of the Financial Year following the year for which profits are calculated, which in the instant case is from January 01, 2017 to December 31, 2017.
30. Accordingly, the decrease in consumers' class wise tariff, on account of clawback of profits for Financial Year 2015-16, except for the life line consumers, based on units sold from January 01, 2017 to December 31, 2017 i.e. 13,770.38 GWh based on Authority's approved target of T&D losses, works out to minus Rs.1.2012/ kWh, for each of the four (04) quarters from January 01, 2017 to December 31, 2017, which is hereby approved. Since the period from January 2017 to December 2017 has already lapsed, therefore, the amount of claw back shall be passed on to the consumers during the twelve months period immediately following the notification of this decision based on units sold, during the period from January 2017 to December 2017.

AUTHORITY


(Saif Ullah Chattha)

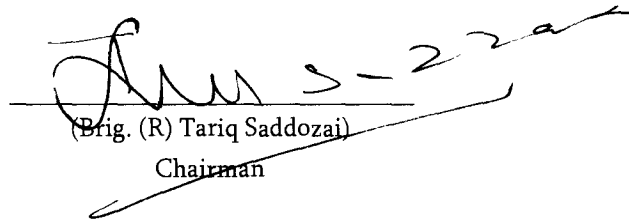
Member

26.10.2018

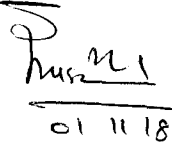

22/11/2018

(Rehmatullah)

Member/Vice Chairman


(Brig. (R) Tariq Saddozai)
Chairman




01/11/18