NATIONAL POWER TARIFF AND SUBSIDY POLICY GUIDELINES 2014

PREFACE

The purpose of this document is to present a National Power Tariff and Subsidy Policy guidelines for the country.

The National Power Policy of 2013 describes sustainability in the power sector as *"the underpinning of long term transformation. The principle of sustainability will be grounded on three pillars: low cost energy, fair and level playing field, and demand management. Altering the fuel mix towards less expensive fuels will lead to low cost energy. Investments required for the low cost fuel mix will necessitate rationalization of the electricity tariff. Fairness will be ensured by protecting the poor and cross-subsidizing their consumption from the affluent. A level playing field will be created by providing power at comparable prices to all industrial users. Demand management will be introduced through novel policy, pricing and regulatory instruments."*

NATIONAL POWER POLICY OF 2013
The National Power Policy of 2013 states a Vision for the country: "Pakistan will develop the most efficient and consumer centric power generation, transmission, and distribution system that meets the needs of its population and boosts its economy in a sustainable and affordable manner."

Power sector reform in the country is witnessing a progressive tariff rationalization process. As the power sector requires a significant amount of resources to meet current and future customer demand, its ability to attract commercial capital needs to be ensured through relevant policy and regulatory actions. It is in this context that the National Power Tariff and Subsidy Policy guidelines 2014 strikes a balance between the interests of consumers and the interests of providers of capital. The policy enhances predictability and financial viability through the tariff setting process. Lastly, the policy facilitates the growth of competition in the electricity industry.

The National Tariff and Subsidy Policy guidelines 2014 takes into consideration the existing legal framework and emerging trends in the sector, in terms of:

(a) Promotion of efficiency,
(b) Introduction of conservation through pricing,
(c) Rationalization of electricity tariff,
(d) Protection of consumer interests and
(e) Transparency in subsidy administration,

OBJECTIVE

The objective of the National Power Tariff and Subsidy Policy guidelines 2014 is to state the intent of the Government of Pakistan with respect to electricity pricing and cost allocation so that policy-makers, planners, companies, regulators, and customers have a concrete picture of the steps necessary to achieve a sustainable power sector for the country.

SHORT-TERM OBJECTIVE

The short-term National Power Tariff and Subsidy Policy guide 2014 is to provide a tariff regime that covers the cost of service, including a Government subsidy within annually budgeted amount. The short-term goals regarding subsidies and tariffs, include steps to:

(i) Streamline the regulatory process for tariff approval;

(ii) Clarify the Government policy on electricity subsidies; and

(iii) Provide relevant stakeholders with policy guidance on main tariff principles and measures established in the NEPRA Act (1997 Act to provide for the regulation of generation, transmission and distribution of electric power) and the National Power Policy 2013.

MEDIUM-TERM OBJECTIVE

The medium-term National Power Tariff and Subsidy Policy guidelines 2014 is to provide a tariff regime that covers the cost of service as determined on the basis of a least cost integrated generation, transmission and distribution expansion plan, with limited subsidies targeted to customers most in need of financial support, consistent with the national subsidy policy guidelines.

LONG-TERM OBJECTIVE

The Long-Term National Power Tariff and Subsidy Policy 2014 is to provide a robust, reliable, power sector with ample generation reserves for a growing economy where generation prices are determined competitively, and cost-based or incentive rates are determined by a responsive regulator for the public transmission system serving a transparent market for trading power and highly reliable private or public distribution companies. Subsidies for low-income customers are provided through transparent tariffs cross subsidized by high demand residential customers or through the national safety net.

TARIFF POLICY GUIDELINES

The Tariff Policy guidelines serves these objectives by:

1. Ensuring financial viability of sector entities while protecting interests of the consumers:

This policy will entail allowing all efficiently incurred costs (with realistic and uniformly applicable efficiency benchmarks) in tariff setting but disallowing inefficiencies to prevent them from being passed on to the consumers. Ensuring financial viability will hold the key to: (i) mobilization of adequate resources for the sector and (ii) attracting multiple players in the sector thereby increasing the possibility of introducing higher level of competition.

2. Ensuring predictability in regulatory actions:

The National Power Tariff and Subsidy Policy guidelines 2014 provide guiding inputs for regulatory actions in tariff setting as envisaged in the NEPRA Act. So accordingly the future Tariff Determination Process should follow the below:

- Through a separate independent proceeding (Separate from tariff hearing) NEPRA approves the medium- to long-term integrated least cost generation, transmission and distribution expansion plans in line with National Power Policy 2013 .
- Transmission charge or use-of-system charge of NTDC shall be determined by NEPRA on multiyear basis to be made effective from FY 2015-16 once the plan has been approved as described above.
- Distribution margin for all the distribution companies shall be determined by NEPRA on multiyear basis to be made effective from FY 2015-16 once the plan has been approved as described above.
- Pool generation charge and other indexation relevant to annual tariff or multiyear tariff regime shall be determined by NEPRA on annual basis and coupled with the determination of a forward looking fuel price through *suo moto* proceeding for the FY 2014-15.
- The Government intends that NEPRA issues a timely decision consistent with their current rules. It is critical that there be proper submissions to NEPRA by the Discos and that NEPRA addresses tariff petitions in accordance with their rules.

- To ensure that the tariff progressively reflects the cost of supply of electricity, the GoP shall notify a roadmap within 12 months with a target to achieve full cost recovery for power companies. The road map, which will be a part of the multi-year tariff filing for the two selected utilities and which would also have intermediate milestones, shall be based on the approach of a gradual reduction in the Government subsidy.

TARIFF STRUCTURING AND ASSOCIATED ISSUES

A. Generation Segment

A two-part tariff structure should be maintained for all long-term contracts to facilitate Merit Order dispatch, except where NEPRA provides separate tariff treatment for renewable energy. This framework would be extended to generating stations (including grid connected captive plants) as per NEPRA Rules. The purchases and contracting of Distribution Licensees' purchases will be subject to NEPRA rules and regulations, in particular for the approval of the pass through and recovery of purchased power and contract costs.

B. Transmission Segment

The transmission system in the country consists of the integrated national grid. In a restructured power sector, transmission charges are the regulated instrument for the transmission company to recover the allowed revenue requirements approved by the regulator to provide the transmission services within the required transmission reliability and performance standards obligations. Therefore, the tariff / charges are to be paid by Transmission Users for the use and access to the transmission system owned by another company (NTDC) to recover the amount.

There is a connection between transmission licensing, the determination of transmission tariff / charges and the transmission expansion plan. As the transmission tariff determination includes the review and approval of investment costs, the standard good practice for determining a transmission tariff and issuing a transmission license is to have an approved transmission plan, which identifies the approved investment projects to be included in the NTDC's revenue requirement and recovered through NEPRA-approved transmission charges.

NEPRA should accelerate the NTDC tariff determination by ensuring that the expansion plan is proposed by NTDC, reviewed (including hearings as necessary) and approved by NEPRA in a separate proceeding, prior to an annual or a MYT tariff petition and tariff determination hearing. This approach will properly shield the investments included in the NTDC data from being visited for the first time during the regulatory hearing to determine transmission tariff/charges in response to a tariff petition. NEPRA should move to a Multi-Year Tariff for NTDC that is consistent with the 5 Year expansion Plan and the Grid Code.

C. Distribution Segment

Supply of reliable and quality power of specified standards in an efficient manner and at reasonable rates is one of the main objectives. The regulator determines and notifies the standards of performance of licensees with respect to quality, continuity and reliability of service for all consumers.

Making the distribution segment of the industry efficient and solvent is the key to success of power sector reforms and provision of services of specified standards. Therefore, NEPRA needs to strike the right balance between the requirements of the commercial viability of distribution licensees and consumer interests. As the owner, GoP intends to transform loss-making utilities into profitable ventures which can raise necessary resources from the capital markets to provide services of international standards to enable Pakistan to achieve its full growth potential.

The O&M costs allowed by NEPRA and other benchmarks need to be revisited by the distribution companies and the Regulator. Specifically, Distribution Companies have an obligation to meet the cost parameters in the NEPRA tariffs; they must make every effort to comply with NEPRA directives concerning technical and commercial losses.

A Government policy of full cost recovery and improved governance is critical to improve Aggregated Technical & Commercial Losses (ATCL). These two initiatives must be tied together. Enhanced revenue collection and better governance by utilities must be understood to be a key element of cost recovery. When successful, these joint activities will result in reduction of circular debt on a sustainable basis. ATC loss reduction should be incentivized by linking returns in a MYT framework to an achievable trajectory. Greater transparency and nurturing of consumer groups would be efficacious.

Pass through of past losses (within the parameters set forth in para-1 under the subheading "Tariff Policy Guidelines" above) or profits should be allowed to the extent caused by uncontrollable factors. During the transition period controllable factors should be to the account of utilities and consumers in proportions determined under the MYT framework.

There is a connection between distribution licensing and distribution margin/ charges determination, and distribution expansion plan. As the distribution margin determination includes the review and approval of investment costs, the standard good practice for distribution is to have an approved distribution plan, which identifies the approved investment projects that therefore should be recovered in a DISCO's approved revenue requirement and distribution margin / charges.

EQUALIZATION SURCHARGE FOR DISCOS

NEPRA should accelerate the DISCO's tariff determination by ensuring that the expansion plan proposed by the DISCO is reviewed (including as necessary hearings) and approved by NEPRA in a separate proceeding, prior to an annual or a MYT tariff petition and tariff determination hearing. This will enable that tariff determination review and hearings not to question the investments included in DISCO's data in the tariff petition. NEPRA shall implement tariffs which incorporate a rate structure such that the end use tariff shows separate prices for generation pool charge, NTDC charge, distribution charge, and subsidies separately on the consumers' bills.

Equalization surcharge is an inter-Disco subsidy. As long as Government maintains the uniform national tariff, there will need to be an equalization surcharge, to balance the different cost profiles of different distribution companies. NEPRA shall develop a mechanism to determine the quantum of the equalization surcharge. This separate amount shall appear separately on the bills of applicable customer categories.

NEPRA should move to a Multi-Year Tariff for DISCOs that is consistent with the expansion plan as described in para-2 of the "Tariff Policy Guidelines" and the Distribution Code.

D. Multi-Year Tariff (MYT)

A multi-year tariff (MYT) would minimize risks for utilities and consumers, promote efficiency, allow for appropriate reduction of system losses, attract investments and would also bring greater predictability to consumer tariffs on the whole. An MYT would restrict tariff adjustments to known indicators on power purchase prices and inflation indices. The framework should be applied for both public and private utilities. NEPRA shall immediately develop a process, rules and procedures to address a regime for multi-year tariffs, including an adjustment mechanism for subsidies as defined under the heading "Subsidy Policy Guidelines" below.

The regulator should introduce mechanisms for sharing of excess profits and losses with the consumers as part of the overall MYT framework, which should be in line with the para-1 of the "Tariff Policy Guideline" above . In the first control period the incentives for the utilities may be asymmetric with the percentage of the excess profits being retained by the utility set at higher levels than the percentage of losses to be borne by the utility. This is necessary to accelerate performance improvement and reduction in losses and will be in the long-term interest of consumers by way of lower tariffs.

As the metering is completed up to the appropriate level in the distribution network, it should be possible to segregate technical losses. Accordingly, the technical loss reduction under a MYT framework should then be treated as distinct from a commercial loss reduction, which requires a different approach. Estimates of technical losses would be a simulation of the distribution system components and loads. Standard practices in a MYT loss trajectory performance tend to be defined for total losses, as both need to be managed: adequate investment to avoid technical losses that are too high (due to factors such as overload) and adequate investment also to avoid technical losses that are too high (also due to overload) and adequate control programs to reduce commercial and non-technical losses.

The MYT framework implemented in the year 2015-16 in two of the DISCOs should have adequate flexibility to accommodate changes in the baselines consequent to metering being completed.

E. Consumer Tariff and Protection of Consumer Interests

The interest of consumers shall be granted careful consideration in setting tariffs. The distribution companies shall continue to be accountable to their customers.

There is an automatic adjustment mechanism for non-payment of receivables beyond a specified period by respective Federal and Provincial Government agencies or departments. It is the Policy of the Government that the Federal Government shall make payments to the power sector within 45 days of receipt of a bill.

F. Forward Looking Fuel Clause

The current fuel adjustment mechanism needs to be revised. Regardless of whether electricity tariffs for distribution companies are determined using an annual or multi-year tariff-making regime, NEPRA should devote sufficient resources to the adoption of a forward-looking fuel price adjustment mechanism for all distribution companies, which will provide intermediate and end users of electricity with more stability with respect to planning and managing their expenditures on electricity throughout the year.

The forward-looking fuel clause approved by NEPRA would incorporate *ex post* at the appropriate point in time near the end of the financial year the annual, quarterly and monthly un-forecasted and unexpected changes in fuel costs and their attendant effects on the price of purchased power, operations and maintenance costs, transmission costs and variations in the market prices of the fuel used to generate electric power in Pakistan.

G. Reduction in Circular Debt

The Circular Debt is the amount of cash shortfall within the Central Power Purchasing Agency (CPPA), which it cannot pay to power supply companies. The overdue amount is a result of: (a) the difference between the actual cost and the tariff determined by National Electric Power Regulatory Authority (NEPRA) which is the Distribution Company's loss over and collections under that allowed by NEPRA, (b) the delayed or non-payment of subsidies by government, and (c) delayed determination and notification of tariffs. It is the government's policy to reduce, limit to a certain amount which would be reduced over time, and eliminate the causes of the circular Debt. It is the policy of the GoP that the circular debt of the power sector be eliminated through bringing in efficiency by reduction of losses, improvement in management and recovery and switching to lower cost fuels and power generation through cheaper sources of fuel.

SUBSIDY POLICY GUIDELINES

Pakistan has maintained a commitment to a uniform national tariff. For the now the uniform national tariff will continue. However, the GoP will review its commitment to a uniform national electricity tariff by requiring NEPRA to examine more innovative tariff mechanisms as power sector companies become more stable and provide reliable and affordable power to their customers to bring efficiency, conservation and transparency.

There are numerous subsidies within the Pakistan power sector. There are direct subsidies from the Government, cross subsidies and inter-disco subsidies.

The subsidies which are now being provided across the board will be rationalized and optimized by targeting it to the deserving segment of consumers. With the application of a more rational tariff subsidy mechanism wherein the GoP intends to continue to provide for the poorest classes of electricity customers by targeting the low-income customers, A more efficient price signal will be sent to high use customers, which should contribute to energy efficiency.

A. Subsidy Policy for Low Income Residential Customers

The GoP will continue to provide direct subsidies to the extent they consider appropriate. Subsidies will be targeted effectively and in transparent manner to reach consumers using not more than 200 kWh per month in accordance with the National Power Policy 2013 and especially those currently on the lifeline tariff.

In accordance with the National Power Policy 2013, consumers below the poverty line who consume below a specified level will receive special support through cross subsidy.

The Rate design principles and policy for low-income domestic consumers (e.g. the lifeline tariff) will ensure that subsidies reach those in need, not all customers. Consumers using up to 200 kWh in every month of the year will be subsidized. For residential consumers using more than 200 kWh per month, the subsidy will be eliminated. The supporting tariff policy is to ensure that residential customers, as a customer class, are charged the full cost of service. The average tariff of all residential customers will correspond to the cost of service by obtaining cross subsidies from other customers.

NEPRA will review the minimum customer service charge as it reviews rate design issues. It may be that several differentiated residential customer service charges are necessary so that poor customers are not required to pay an amount greater than they can afford to connect to the electricity system.

B. Subsidy Not to Exceed Amount Funded by National Budget

Subsidy funding is clarified by the Government such that in the midterm, tariffs shall not require a subsidy that is greater than the amount funded by the National Budget (i.e. the direct subsidy from the GoP) and cross-subsidies provided by the consumers of electricity. If interim adjustments are required to ensure that the amount subsidized does not to exceed the amount in the National Budget, then after consultation with GoP, NEPRA will undertake an adjustment similar to the way it administers adjustments to fuel prices.

NEPRA shall immediately develop a process to address cost overruns in subsidy adjustment applicable to all DISCOs during the determination of their electricity tariff regardless of these tariff determinations occur on under an annual or multi-year regime. This would ensure the control and management of the overall subsidies provided by the GoP to the power sector.

In the longer term it is intended that electricity tariffs will cover the cost to serve all customers.

In the determination of electricity tariffs, NEPRA will take into account any subsidy amount informed and provided by the GoP through the National Budget.

--