JUDGMENT SHEET
IN THE ISLAMABAD HIGH COURT, ISLAMABAD
JUDICIAL DEPARTMENT

OGRA Application no.3/2026
Sui Southern Gas Company Limited
versus
Oil and Gas Regulatory Authority

For the Applicant:	M/s Muneeb Zia, Hassan Muneeb Zia and Mouood Fiaz, Advocates Saeed Rizvi, DMD (Operations), Asad Mustafa, GM (Regulatory Affairs), Muhammad Kamran GM (Billing), Farhan Umer, GM (Measurement Transmission) and Syed Asad Abbas Naqvi, DCM-Legal, SSGC
For the Respondent:	Barrister Abdullah Manik, Advocate Muhammad Rizwan ul Haq, SED (Litigation), Sajid Zahid Rauf, ED(Gas), Azhar Nizam ED(Gas) and Muhammad Tariq DED (Finance) OGRA via online
Date of Decision:	**13.11.2026**
Date of hearing:	**12.10.2026**

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Sardar Ejaz Ishaq Khan, J:

1 THE PETITION

1.1 The applicant, Sui Southern Gas Company Limited (the "applicant", or "SSG") has filed this application under section 12(2) of the *Oil and Gas Regulatory Authority Ordinance, 2002* (the "Ordinance"), impugning the decisions dated 11.12.2025 and 06.10.2025, passed by the respondent, Oil and Gas Regulatory Authority ("OGRA", or the "Authority"). The impugned decisions were passed on SSG's petition for its Final Revenue Requirement (the "FRR-25 determination") for the financial year 2024-25 (FY-25), and on SSG's motion for review of the FRR-25 (the "MFR-25 determination").

for read only

1.2 SSG raises seven claims in this petition, contending that OGRA should have allowed them in FRR-25 determination or, alternatively, in the impugned review MFR-25 determination. The first claim concerns capital costs. Although presented as separate heads, the remaining six claims concern "unaccounted for gas" (UFG) and are, in substance, sub-claims of the overarching claim concerning UFG volumes. This judgment nevertheless examines them in the order presented in the petition.

1.3 Section 12(2) is a unique provision, importing the language of Article 199 (1) (a) of the Constitution of Pakistan, for the High Court to sit in judgement over the decision passed by OGRA. Section 12(2) is reproduced below:

> 12. Appeal, etc. …
>
> (2) In relation to any decision concerning a regulated activity, the High Court may, if it is satisfied that no other adequate remedy is provided, on application of an aggrieved party, make an order__
>
> (a) directing the Authority to refrain from doing anything it is not permitted by law to do, or to do anything the Authority is required by law to do; or
>
> (b) declaring that any act done or proceeding taken by the Authority has been done or taken without lawful authority and is of no legal effect.

The title to section 12 is "Appeal, etc.". Sub-section (1) expressly stipulates an appeal to OGRA from a decision of a delegate of the Authority under section 10. Sub-section (2) does not use the word 'appeal'; instead, it uses the word 'application'. Sub-sections (2)(a) and (2)(b) import the language of judicial review in Article 199 for the purposes of the application under section 12(2) of the OGRA Ordinance.

1.4 If it were the intent of the legislature to provide an appeal in the conventional sense, then a much simpler formulation could have been expected, but the use of language almost identical to that in Article 199 implies that the legislature intended the principles of judicial review to be applied while hearing an application under section 12(2) from a decision of the Authority. It is therefore concluded that section 12(2) does not envisage a full-fledged appeal in the conventional sense where the entire case on facts and on law is open before the appellate court; rather, the scrutiny by the High Court under section 12(2) is to be carried out on the same principles as would judicial review of an order passed by a public agency.

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1.5 Submissions were heard from the learned counsels as to the scope of section 12(2). Mr. Abdullah Manik, Barrister, appearing for SSG, cited *Sui Southern Gas Company Ltd. vs. OGRA* (PLD 2017 Sindh 567); *SNGPL vs. Federation of Pakistan* (2025 MLD 118 [Peshawar]); and *Gazcon CNG v. OGRA* (2022 CLC 1561 [Islamabad]). These judgments affirm, by and large, the view expressed in para 1.4 above. However, I would add that, in appropriate cases, the exercise of judicial review spans the substantive aspects of the impugned decision also, by applying the tests of illegality, unreasonableness, arbitrariness, and irrationality, and is not confined to review of the procedural aspects only of the impugned decision, and to that extent the observations in some of these judgments confining the scope of section 12(2) to 'procedural oversight' only need to be taken with caution, or else, an impugned decision patently incorrect on merits on the anvil of generally accepted regulatory norms would stand if the parameter of procedural justice alone was applied. Judicial review also rectifies errors patent on the record, including misreading or non-reading of evidence, a perverse conclusion in the sense that no reasonable public authority would arrive at such a conclusion, and a disregard of the doctrines of proportionality[1] and legitimate expectation. If the error is patent, then, solely because the authority had the statutory jurisdiction to render 'a' decision does not entail as a matter of law and equity that it was also empowered to render 'the' decision. The Supreme Court held in *Asif Fasihuddin Khan Vardag vs Government of Pakistan and others* (2014 SCMR 676) that the grounds for judicial review encompassed *illegality, irrationality, and procedural impropriety*. In *M. Hamad Hassan vs Mst. Isma Bukhari and others* (2023 SCMR 1434), laying out the evolution of judicial review in Pakistan, the Supreme Court observed at para 4 as follows:

> In Constitutional jurisdiction when the findings are based on mis-reading or non-reading of evidence, and in case the order of the lower fora is found to be arbitrary, perverse, or in violation of law or evidence, the High Court can exercise its jurisdiction as a corrective measure. If the error is so glaring and patent that it may not be acceptable, then in such an eventuality the High Court can interfere when the finding is based on insufficient evidence, mis-reading of evidence, non-consideration of material evidence, erroneous assumption of fact, patent errors of law, consideration of inadmissible evidence, excess or abuse of jurisdiction, arbitrary exercise of power and where an unreasonable view on evidence has been taken.

[1] The doctrine of proportionality was applied by the Supreme Court in *Sabir Iqbal vs Cantonment Board Peshawar and others* (PLD 2019 SC 189)

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2 THE LEGAL FRAMEWORK FOR GAS TARIFFS

2.1 OGRA Ordinance and Tariff Rules

2.1.1 The tariff setting process is described in brief in paragraph 6 of OGRA's reply as follows:

> In view of the aforesaid statutory framework, the licensee, in terms of Rule 4 of the Tariff Rules, files its Estimated Revenue Requirement ("ERR") in advance for the forthcoming Financial Year ("FY"), upon which OGRA evaluates and determines the estimated revenue requirement, forming the basis of its advice to the Federal Government for prescribed consumer prices. Upon close of the financial year, the licensee submits its Final Revenue Requirement ("FRR") based on audited accounts, which is thereafter evaluated and determined by OGRA in accordance with the OGRA Ordinance and Tariff Rules, allowing only such costs as are prudent, cost-effective, and efficient, which in turn forms the basis of advice to the Federal Government under Section 8 of the OGRA Ordinance for the purposes of prescribed prices ultimately born by the consumers.

2.1.2 Section 8 of the OGRA Ordinance, in so far as relevant, reads as follows:

> 8. Pricing for retail consumers for natural gas. __ (1) The Authority shall determine an estimate of the total revenue requirement of each licensee for natural gas engaged in transmission, distribution and the sale of natural gas to a retail consumer for natural gas, in accordance with the rules, and on that basis advise the Federal Government the prescribed price of natural gas for each category of retail consumer for natural gas.
>
> (2) A licensee for natural gas referred to in sub-section (1), shall submit for review by the Authority its total revenue requirement after incorporating the actual changes in the well-head prices, as notified by the Authority and other relevant factors and the Authority shall advise the Federal Government promptly of the revised prescribed prices for the licensee for natural gas. …
>
> (6) In this section__
>
> (h) "total revenue requirement" means for each financial year, that total amount of revenue determined by the Authority for each licensee for natural gas so as to ensure it achieves the rate of return provided in its licence for natural gas.

2.1.3 Consistent with section 8, OGRA rendered its ERR-25 determination on 17.12.2024, followed by its impugned FRR-25 determination on 06.10.2025, culminating with its impugned MFR-25 determination on 11.12.2025.

2.1.4 Section 8 is to be read with section 7, which, in relevant part, reads as follows:

> 7. Tariff (1) Subject to policy guidelines, the Authority shall determine or approve tariff for regulated activities whose licences provide for such

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determination or such approval or where authorized by this Ordinance.

(2) The criteria for determination, approval, modification and revision of tariffs shall be prescribed in the rules and in the terms and conditions of each licence and shall, inter alia, include__

(a) provision for the protection of users of regulated activities and consumers against monopolistic or oligopolistic pricing;

(b) cost of research, development and capital investment programme;

(c) provision of reasonable returns to attract investment of the quantitative and qualitative improvements of regulated activities;

(d) encouragement and reward of efficiency;

(e) sending of appropriate price signals regarding the relative abundance or scarcity of supply of such regulated activity;

(f) minimising economic distortions; and

(g) keeping in view the costs of alternate or substitute sources of energy.

2.1.5 Per section 7(2), the *Natural Gas Tariff Rules, 2002* ("Tariff Rules") were prescribed, expanding on the tariff-setting principles per section 7(2). The Tariff Rules prescribe evaluation criteria[2] for tariffs, spread over 14 sub-paragraphs. The main evaluation criteria per the Tariff Rules relevant to this case are reproduced below:

17. Evaluation criteria. (1) All petitions filed under these rules shall be evaluated by the Authority on the basis of and in accordance with the following criteria, namely- …

(d) tariffs should be determined in a manner which promotes continued reasonable investment in equipment, facilities and research and development for qualitative and quantitative improvement in the provision of regulated activities;

(h) tariffs should generally be determined taking into account a rate of return as provided in the licence, prudent operation and maintenance costs, depreciation, government levies and, if applicable, financial charges and cost of natural gas;

(j) only such capital expenditure should be included in the rate base as is prudent, cost effective and economically efficient …

2.2 Revenue Requirement, Rate of Return, Rate Base

[2] These evaluation criteria, in large measure, mimic the criteria for setting electricity tariffs under the NEPRA tariff rules.

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2.2.1 Section 8 of the OGRA Ordinance dictates that OGRA will determine the gas tariffs to meet the licensees' *total revenue requirement*. This expression, as defined in section 8(6)(h), as the number which achieves the *rate of return* stipulated in the license, is misleading as stated. The rate of return is a percentile number, which can still be achieved on a *rate base* smaller than the one demanded by the utility. A rate of return of 20% on a rate base of one billion will yield 200 million, whereas for a 2 billion rate base it will yield 400 million. The essence of revenue requirement regulation is not the rate of return alone; the rate base on which that return is to be earned is its inseparable twin. The ensuing discussion expands on these key concepts to set the context for this judgment.

2.2.2 Revenue requirement and rate of return are complementary concepts. As methods of regulation, 'cost of service', 'revenue requirement', and 'rate of return', by and large, refer to the same method of regulation. This method of regulation, if practised on an annual basis, as is mandated under section 8, is instrusive, costly, and causes 'regulatory lag', where the incurred costs are recovered under a regulatory determination that comes much after the event. This method entails an essentially adversarial process, with evidence-based regulatory hearings, leading to a 'determination' for each tariff year. Overtime, other methods of regulation have emerged, such as price-cap, multi-year tariffs, or incentive regulation, which allow the utility freedom to vary the tariffs over several years, subject to price caps, with reduced number of periodic approvals from the regulator[3]. Baldwin[4] records that "*This regime, or a version of it, was widely practised in regulatory industries in the United States until about 1990*". During the hearings, when questioned as to why OGRA has not considered moving on to more modern and less intrusive methods of regulation, OGRA's answer was that it was bound by the OGRA Ordinance. That Ordinance remains frozen in the construct of the regulatory practices in the USA of more than three decades ago.

2.2.3 The standard equation[5] capturing the components of the revenue requirement is the following:

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[3] For a detailed discussion on this topic, see *Understanding Regulation, Theory, Strategy, and Practice, Robert Baldwin* et al., Oxford University Press.
[4] Ibid.
[5] *Regulatory Finance, Utilities Cost of Capital, Roger A Morin,* A Public Utilities Reports Inc. publication, 1994

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Revenue Requirement = Cost of Service

$$R = O + D + T + kB$$

Where:

R =	revenue requirement
O =	operating expenses
D =	depreciation allowance
T =	taxes
k =	a fair rate of return
B =	rate base

2.2.4 Setting utility tariff under this method entails two stages: the first is determining the aggregate sum of the revenue requirement, the second is to develop the structure of the tariff to recover the revenue requirement. *Morin*[6] describes the first stage, which this case is all about, as follows:

> The rates set by the regulators should be sufficient to cover the utilities costs, including taxes and depreciation, plus an adequate dollar return on the capital invested. The expected return in dollars, or profit, is obtained by multiplying the allowed rate of return set by the regulator by the "rate base".

2.2.5 The amount of the return is calculated by the application of a percentage rate of return to a rate base. Stated simply, the rate base is the sum total of the values of the plant, machinery, equipment, and assets, deployed by a utility to deliver the licensed services to the consumers. The measurement of the rate base is "…*the most widely disputed legal issue in the history of American public utility regulation.*"[7] The debate centred around the 'original cost' versus 'fair value' of the assets that should go in the rate base; the latter test, stated in somewhat simplistic terms, is the replacement value of those assets.

2.2.6 Stepping aside this debate, what concerns us here is the 'prudence' principle applicable to the inclusion of assets in the rate base. As will be discussed later, the 'prudence test' was pleaded by OGRA to deny inclusion of the costs claimed by SSG in its tariff petitions. OGRA therefore applies the prudence test for the inclusion or disallowance (as the case may be) of the claimed capital and other costs in the rate base.

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[6] Ibid.
[7] Bonbright, Ch 11, Principles of Public Utility Rates, 2nd Edition, James C. Bonbright et.al; Public Utilities Reports, Inc.

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2.3 Prudence Test

2.3.1 In regulatory parlance, prudent investment is the original cost minus any fraudulent, unwise, or extravagant outlays that should not be a burden on ratepayers[8]. The prudence test is criticised by the utilities as the 'last resort scissors', to disallow costs that the regulator does not want to allow. It is criticised as being vague and incapable of offering any *ex-ante* guide for management decisions, which are evaluated after the event by the regulator with hindsight, instead of the foresight the utility managers are meant to exercise. The criticism is not entirely off the mark.

2.3.2 The common agreed description of the prudence test is that the assets to be included in the rate base must be "used and useful".[9] That is a reasonably good test. But, as discussed later, the application of this test does not preclude allowance of the cost of capital employed in constructing or rehabilitating the network until the asset is put to use *fully*, especially where the regulator is in agreement (as it was in the ERR-25 determination preceding the impugned decisions) that the dilapidated pipelines and ancillary assets must be progressively replaced or rehabilitated.

3 1ST CLAIM: THE NETWORK REHABILITATION COSTS

3.1 SSG's case

3.1.1 SSG's ERR-25 petition claimed PKR 23,199 million for rehabilitation of certain segments of SSG's old pipeline network for FY-25. In the ERR-25 determination, OGRA allowed PKR 2,188 million at the ERR stage, and deferred the remaining part of this cost to the determination of FRR. In the FRR-25 determination, OGRA allowed another PKR 10,215 million to be included in the rate base, thereby leaving a balance of PKR 9,165 million. The allowed sum was based on 'previous year's capitalization', but this expression and its rationale was not explained insofar as its nexus with the actual cost for FY-25 was concerned. SSG then filed its motion for review of FRR-25 determination, under section 13 of the Ordinance read with rule 16 of the Tariff Rules, which led to the impugned MFR-25 determination. The reasons for disallowing PKR 9,165 million for inclusion

[8] Ibid.
[9] For a detailed discussion on this test, see the books referred in this judgment.

for read only

in the rate base for FY-25 are stated in paragraph 4 of the impugned decision in the following terms:

> 4.2 The petitioner has stated that it undertook the rehabilitation of approximately 2,500 km of network and successfully achieved the targeted scope of work, with the entire rehabilitated network now operational and delivering economic benefits to consumers. The petitioner has further clarified that the shifting of services and meters from the old to the new network is currently in progress without any disruption in gas supply to consumers. Upon completion of the service connections, the old network will be de-energised/ decommissioned, enabling the petitioner to accurately assess the UFG savings realized against the incurred expenditures, which will be reported in the subsequent quarter. The petitioner has also subtracted that factors such as the design life and current operational integrity of the distribution network are duly considered for prioritization and selection of rehabilitation schemes.
>
> 4.3 The Authority observes that, as per the petitioner's own submission, the old and leaky network remains operational and has not yet been fully de-energized/decommissioned. It is observed that mere pressurizing the newly laid distribution network under the head without completely shifting the service lines of consumers from old leaky network defeats the very purpose for which the project was initially allowed at the ERR stage. In this regard, the petitioner was also directed to clarify the date of decommissioning of the old network. In response, the petitioner submitted data indicating that the segments of the old network corresponding to the newly laid network were not fully decommissioned during the said financial year.
>
> 4.4 Accordingly, the Authority upholds its earlier decision and maintains the pendency of the amount of Rs.9,165 million. The said amount be classified under Capital Work-in-Progress until the old and leaky network is completely de-energized/decommissioned and all consumers are completely shifted to the new rehabilitated network, subject to verification and confirmation by an independent third-party auditor.
>
> 4.5 The Authority has also serious concern over the inflated 'Road Restoration Charges (RCC)' incurred during the subject activity. The petitioner is advised to take up the matter with the relevant authorities, i.e., the Town Municipal Corporation (TMC), and negotiate a rationalization of these charges to avoid placing an undue burden on consumers. Only prudent 'Road Restoration Charges', duly verified by a competent third-party technical engineering firm based on the actual scope of work, may be considered in upcoming revenue requirements.
>
> (emphasis supplied)

3.1.2 It is SSG's case that OGRA did not rebut the incurrence of the capital cost under this head and that expression of a concern on the seemingly inflated road restoration charges (RRC) without rebutting that those charges were actually incurred was unreasonable and irrational, violating the legitimate expectation that incurred costs would be included in its rate base for the purposes of calculating

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the revenue requirement for FY-25. Mr. Muneeb Zia, appearing for SSG, emphasised that OGRA did not dispute that a significant number of consumers had been transferred to the new network, resulting in benefits accruing to the consumers and to the petitioner in terms of reduction of gas leakages. He further added that, from an operational perspective, it was not safe and prudent to de-energise the old network all of a sudden without the consumer migration being completed, which was a gradual process to be undertaken over an extended timeline in order not to compromise the safety and continuity of supply of gas to the consumers. He further added that OGRA's concern on the quantum of the RCC was unfounded because these were documented expenses paid to town municipal corporations, metropolitan corporations, city development authorities, cantonment boards, and other administrative entities. He continued that, if the Authority had concern over the quantum of RCC, it could flag those concerns and develop processes and procedures in consultation with SSG so that, in future, the quantum of RCC could be verified independently under a third party audit or, in the alternative, OGRA could itself take up the issue at the highest levels of the provincial government for rationalisation of the RCC for they translated into a corresponding increase in the consumer tariff, but SSG's legitimate expectation of incurred capital costs to be included in the rate base in the year they were incurred could not be defeated by a 'concern' alone, and certainly not on the basis that no capital expenditure recovery would be allowed until the last consumer was shifted to the new network.

3.2 OGRA's reply

3.2.1 OGRA's reply, generally for all claims reitereated in SSG's motion for review, was that section 13 of the Ordinance, read with rule 16 of the Tariff Rules, precluded review unless a change in circumstances or discovery of new evidence was demonstrated, which, per OGRA, was not demonstrated, and, therefore, the motion for review was not competent.

3.2.2 On merits, OGRA's reply was to the effect that the network rehabilitation costs were presented by the petitioner as a subset of its programme for reduction of 'unaccounted for gas' (UFG), improved pressure management, and enhanced system efficiency. OGRA's view was that, as the full benefits of the new network were not translated *fully* into actual use by the gas consumers, it was not 'prudent' to allow the full capital cost recovery as some part of the new network

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was still not energised. This view is summarised in paragraph 17 of OGRA's reply as follows:

> In such circumstances, the fundamental objective of rehabilitation i.e. replacement of defective infrastructure to achieve efficiency gains, UFG reduction and improved operational performance, had not yet been fully realised and passed on to the consumer.

3.3 Analysis

3.3.1 SSG disputed OGRA's stance, saying that the UFG benefits had been accruing in tandem with the progression of consumer-migration to the new and rehabilitated network, and it was contrary to all norms of utility practices to deny the progressive realisation of UFG reductions. A rather unwieldy debate ensued during the hearings, with presentations by SSG on UFG savings in the migrated network segments. That the precise correlation of the UFG savings to the quantum of capital costs was not agreed between OGRA and SSG by the time the impugned decision was rendered, is impliedly conceded by both OGRA and SSG. References were made by each to the correspondence, with accompanying evidence of performance of migrated segments, between OGRA and SSG before, during, and after the MFR proceedings. It is rather unwieldy to go into the minutiae of that correspondence in this judgment, because OGRA ducked the point altogether by parking the disallowed sum under the head 'capital work in progress (CWIP)', as will be shown later.

3.3.2 OGRA's stance essentially rests on the application of the 'prudence' test per Rule 17(1)(j) of the Tariff Rules (reproduced in para 2.1.5). It ruled that, as the rehabilitated network was not energised in its entirety, it was not 'used and useful' in its entirety, and hence not qualified for inclusion in its entirety in the rate base for FY-25 in order for SSG to earn the allowed rate of return thereon. Further, although the impugned decision did not state so expressly, it is implied that the apparently inflated RRC too did not meet the test of prudency for inclusion in the rate base.

3.3.3 Referring to sub-paras (d), (j) and (h) of rule 17(1) of the Tariff Rules, SSG contends that the same Tariff Rules mandate that the allowed tariff should '*promote continued investment by a licensee in equipment and facilities*', and that OGRA must '*allow capital expenditure that is prudent, cost-effective and economically efficient*'.

for read only

3.3.4 The Tariff Rules do not provide a hierarchy of the evaluation criteria. They are written, in no specific order, for both stages of the tariff-setting – revenue requirement first, followed by customer-facing tariff categories and charges to meet that revenue requirement. Some evaluation criteria relate to the first stage, others to the second. Both OGRA and SSG have pleaded the criteria which fall in the first stage exercise.

3.3.5 In a year-on-year revenue requirement calculation, the relative weightage to be given to each first-stage evaluation criterion often remains disputed between a utility and its regulator, and, coupled with the time-lag between incurrence of capital and operating costs and the tariff determination, forces a utility to learn from expensive mistakes, which it does not consider mistakes until it is told so by a shuffle of the criteria in the final tariff determination. This case is one such dispute[10].

3.3.6 Both SSG and OGRA rely on the evaluation criteria in para (j), which, to repeat, provides that "*only such capital expenditure should be included in the rate base as is prudent, cost-effective and economically efficient*".

3.3.7 SSG says it is well-nigh impossible to have 2,500 kms of rehabilitated pipelines energised within one year, and that it is not paying the carrying cost of capital until the last customer is migrated to the new network. It contends that OGRA did not deny the execution of rehabilitation works nor the capital costs incurred thereon, that there was no contrary evidence or expert opinion that the costs were unreasonable or not incurred, that the RRC had already been paid through cheques against challans of municipal authorities, that all cost details, explanations and supporting materials were submitted, and that the rehabilitation costs were previously allowed in FRR-24 without the de-energizing condition. Referring to the relevant para 4 of the impugned MFR-25 determination, learned counsel contended that there was no finding by OGRA that the rehabilitation costs were economically inefficient or were ineffective.

3.3.8 OGRA has a different view. It says SSG will get only the 'used and useful' part of the rehabilitation capital cost added to its rate base for FY-25 to earn a return

[10] That is one of the main reasons why public utility regulation has now migrated to advanced methods of regulation, focusing on a mid-to-long term revenue requirement plan, with overlays of efficiency benchmarks, price-caps, and incentive gains. Section 7(2) of the Ordinance enables such advanced level regulation within the guardrails it sets. But section 8 prevents that happening by mandating a year-to-year tariff plan.

for read only

thereon *for FY-25*, because the unenergized part was not yet proven to be *cost-effective and economically efficient* in terms of para (j). OGRA makes the latter point while referring to the objective of the rehabilitation cost, namely, reduction of UFG, for which it makes an added reference to para (c) of the evaluation criteria in rule 17, that, with the extra verbiage excised, reads as follows:

> Tariffs should include a mechanism to allow licensees a benefit from and penalties for failure to achieve benchmarks set by the Authority through yardstick regulation for, inter alia … capacity utilization, operation and maintenance costs, and unaccounted for natural gas.

OGRA's argument gains strength from that, in terms of SSG's own tariff petition, the rehabilitation costs were placed in Table 7 of the FRR-25 determination under the 'UFG Control Program'. So, this capital investment had a dual purpose; upgrading the network for network longevity *plus* improved UFG control. It had both 'qualitative' and 'quantitative' dimensions, in terms of section 7(1)(c) of the Ordinance, read with rule 17(1)(d) of the Tariff Rules.

3.3.9 The answer to this evaluative dispute is found in the evaluation criteria in para (h), when considered in light of regulatory experience from the US where the regulators and practitioners have long grappled with this issue. Para (h) is again reproduced below for quick reference:

> Tariffs should generally be determined taking into account a rate of return as provided in the license, prudent operation and maintenance costs, depreciation, government levies and, if applicable, financial charges and cost of natural gas. (*emphasis supplied*)

3.3.10 Para (h) mirrors the revenue requirement equation in para 2.2.3 above, without, however, mentioning the rate base on which the rate of return is to be earned. That rate base is mentioned, one para later, in para (j), stating that:

> Only such capital expenditure should be included in the rate base as is prudent, cost-effective and economically efficient.

3.3.11 SSG expresses its loss in terms of the cost of capital employed to finance the rehabilitation costs, plus the loss of depreciation allowance for FY-25 to the extent of the disallowed capital costs of rehabilitation.

3.3.12 The issue really is the carrying cost of capital for capital work in progress, but neither party has identified it as such, both locking horns only on the question whether the capital cost of Rs 9,183 *should be included in the rate base for FY-*

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25. SSG has only one source to finance the carrying cost of debt comprised in this capital outlay until it is included in its rate base – through its return on equity, by foregoing the corresponding sum from its return on equity. Its licensed rate of return, per clause 5.2 of its license, is 17%, before financial charges and tax, to be earned by it on "*the value of its average net fixed assets in operation for each financial year*." The 17% return is calculated on the weighted average cost of capital method, with debt and equity ratio taken as 70:30[11]. If SSG bears the carring cost of its network rehabilitation capital for a given period, its rate of return automatically falls below 17%. This is forbidden under section 8(6)(h) of OGRA Ordinance, which, to recap, mandates that the total revenue allowed to a licensee must "…*ensure it achieves the rate of return provided in its license*…". Unless *ex-ante* benchmarks specific to capital cost efficiency are prescribed[12], it is patently contrary to the essence of rate of return regulation for a utility to pay the carrying cost of capital work in progress out of its return on equity.

3.3.13 OGRA gave only an amber signal to SSG in the ERR-25 determination. To a Rs. 25 billion capital investment programme for rehabilitation of old network presented to it around December 2025 in SSG's ERR-25 petition, it said to SSG, paraphrasing, "*Fine. Include Rs. 2.5 billion now for your project, but don't stop spending, we will see how much of your spend we will allow you at the year-end after your spend has been incurred and your accounts audited. Bring your final figure to us and we will then see how much we will allow almost a year later. If necessary, we will apply the 'prudency scissors*'." What kind of regulatory method for long-gestation capital investment programmes is this? In the absence of express benchmarks for capital cost efficiency regulation, how can OGRA apply the prudence scissors about a year later to a capital outlay essential to be spent on an on-going basis for the long-term integrity of the network? Why did SSG accept it in such vague terms? The Court is at a loss to comprehend. SSG says it was justified to assume that its capital costs would be allowed, because it was allowed to the full as claimed in the FRR for 2024, and that it created a legitimate expectation for FY-25 also. I find that hard to agree with. Nothing in the law or regulatory jurisprudence stipulates that a substantial capital investment programme for a given year, not blessed by the regulator either specifically or

[11] See Table 4 of the FRR-25 determination.
[12] In consultation with the utility, of course.

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under a structed mechanism, will result in incurred capital costs being pass-through in tariff solely because it was done the last year also.

3.3.14 Faced with the same problem, the regulators in the US came up with the AFUDC solution.

3.4 AFUDC vs CWIP

3.4.1 As noted in para 3.3.9 earlier, the answer to this dispute is found in the evaluation criteria in para (h). To recap, para (h) reads as follows:

> Tariffs should generally be determined taking into account a rate of return as provided in the license, prudent operation and maintenance costs, depreciation, government levies and, if applicable, financial charges and cost of natural gas.

3.4.2 Para (h) categorically states the regulatory principle that the 'financial charges' are to be taken into account in determining the tariff, i.e., the revenue requirement recoverable by the tariff. It does not mandate that the financial charges can be taken into account *only* by inclusion in the rate base.

3.4.3 The impugned order records that the disallowed rehabilitation cost is to be treated as capital work in progress (CWIP). The tenor of the impugned order and the submissions at the bar make it evident that the disallowed rehabilitation cost is not included in the rate base, nor any allowance for the corresponding financing costs is made in the FY-25 revenue requirement; SSG is meant to absorb the entire financing costs of the CWIP. The question was put by the Court to the parties during the hearings whether the financial charges – the carrying cost – for the rehabilitation capital cost was included in the revenue requirement for FY-25, and the answer received was in the negative.

3.4.4 The prudency test entails that the consumer should pay a return (in the form of tariffs) only on assets that are 'used and useful'. The flip side is that cost of capital incurred in building new or replacement plant will have to be financed by the utility for the period the plant is being built until it is commissioned, and its return on equity will erode correspondingly for that period if not covered by tariffs for that period.

3.4.5 This issue has been addressed by regulators practicing rate of return regulation by either including CWIP in the rate base – a more expensive proposition, given the

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depreciation allowance thereon – or by including allowance for funds used during construction (AFUDC). The literature on this topic is vast, and this judgment is not the place to set it out in detail, as the determination of AFUDC is being remanded. For quick reference, Annex-A to this judgment reproduces the relevant section from *Bonbright*, where this topic is dealt with in digestible detail. What is indisputable, however, to quote Bonbright, is *"...[t]he propriety of some allowance of this type as a component of the rate base has been conceded by all commissions*", and, that "*CWIP costs not put in the rate base are given AFUDC treatment."*

3.4.6 AFUDC can see many variations, being tailored to the specific circumstances of the utility. AFUDC may be given by capitalising the carrying cost of CWIP in the rate base, recoverable via tariffs either in the same year of CWIP, or in the year that the CWIP is completed and the underlying asset is 'used and useful', or it may be a combination or another permutation, as said, depending on the circumstances. Or, AFUDC may just be confined to loan interest charges attributable to CWIP, as seems to be contemplated by the evaluation criteria listing 'financial charges' in the list in para (h) of rule 17(1). Permutations will be dictated by the utilities' accounting and managerial policies and practices, with the regulator listening and making a fair call in the end.

3.4.7 Paraphrasing *Bonbright*, a balanced approach towards CWIP necessitates that the regulator *(i) mitigate any bias which may discourage additional capital investment in needed facilities, and (ii) enable the need for those facilities to be more accurately evaluated by price signals which reflect <u>today</u> some of the costs associated with future facilities*. These principles are reflected in the tariff criteria per section 7(2)(b) and (c) (capital investment program, reasonable return) and rule 17(1)(d) (continued reasonable investment), of the Ordinance and the Tariff Rules, respectively.

3.4.8 OGRA's approach remained somewhat inconsistent. While regarding the road restoration charges (RRC) as extravagant, OGRA nonetheless included the entire RRC in the CWIP, to be added in the rate base next year or the year after, depending on when the last consumer connection was energised, instead of rejecting the RRC component to the extent it did not consider it verified. Apart from only expressing a 'serious concern', it did not exert itself to be more precise over the translation of its serious concern in Rupee terms, qua the part of RRC it

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would not allow. By not rejecting and including the entire RRC in CWIP despite the serious concern, it signalled its consent to include even the doubtful parts of the RRC in the rate base, only deferred by a year or two. This is, respectfully, far short of the regulatory due diligence a robust and effective regulator is expected to exercise.

3.4.9 The conclusion, therefore, follows that SSG's stance of actual incurrence of the entire sum of the claimed rehabilitation capital cost, including the disallowed sum of Rs. 9,183 million, was not actually rejected by OGRA. For the reasons aforesaid, it cannot refuse to allow, as a minimum, the AFUDC, or call it the 'financial charges' in terms of rule 17(1)(h), without contravening the statutory and sub-statutory provisions noted above.

3.5 Order

Proceeding on the premise that the financial charges – the carrying cost – attributable to CWIP for the network rehabilitation were not included in the final revenue requirement for FY-25:

(a) it is declared, in terms of section 12(2)(b) of the Ordinance, that the impugned decision infringes sections 7 and 8 of the Ordinance by requiring SSG to bear the carrying cost of capital for the CWIP of Rs 9,183/- for FY-25;

(b) this claim of SSG is remanded to OGRA with the directions, pursuant to section 12(2)(a):

(i) to determine the sum representing the financial charges/carrying costs of capital for the CWIP of Rs 9,183/- for FY-25;

(ii) to determine how that sum will be recovered through an allowance for inclusion in the revenue requirement for FY-25;

(iii) in compliance with rules 17(1)(c) and (h), as the rehabilitation plan was intrinsically linked with UFG Control, OGRA may require a migration plan for migration of the consumers to the rehabilitated network, with concomitant, but proportionate, penalties for delay in meeting the migration milestones by way of penalty points under the UFG benchmarks; and

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(iv) to make the determination aforesaid within 60 days of receipt of a certified copy of this judgment, through a speaking order, after hearing the parties, and keeping in view this judgment.

4 2ND CLAIM: DISALLOWANCE OF 1,891 MMCF GAS AS THIRD-PARTY DAMAGES

4.1 The impugned decisions

4.1.1 OGRA disallowed 50% of the total claimed volume of 1,891 MMCF under the head '*third-party damage*' to the network in FRR-25 determination and maintained that stance in the impugned MFR-25 decision.

4.2 SSG's case

4.2.1 SSG claimed that the disallowance was capricious, inconsistent, unjust and unreasonable, because SSG exercised no control over contractors and workers of city governments, telecom companies, property developers, etc., who caused damage to its pipelines causing gas leakages, that it was inconsistent with OGRA's past practice of allowing recovery of the full sum of the claimed cost of the gas lost to third-party damage in the FRR determinations for FY-23 and FY-24, and that, on OGRA's direction, SSG even conducted a third-party audit confirming loss of 1,831 MMCF by third-party damage, which audit report was never disputed by OGRA. The disallowed sum was a direct loss to SSG due to exclusion from its UFG allowance.

4.2.2 Claiming the disallowance as a breach of SSG's legitimate expectation aforesaid, Mr. Zia cited para 6 of the judgment in *National Database and Registration Authority (NADRA) v. Jawad Khan* (2023 SCMR 1381), which reads as follows:

> The doctrine of legitimate expectation connotes that a person may have a reasonable expectation of being treated in a certain way by administrative authorities owing to some uniform practice or an explicit promise made by the concerned authority. In fact, a legitimate expectation ascends in consequence of a promise, assurance, practice or policy made, adopted or announced by or on behalf of government or a public authority. When such a legitimate expectation is obliterated, it affords a locus standi to challenge the administrative action and even, in the absence of a substantive right, a legitimate expectation may allow an individual to seek judicial review of a wrongdoing; and in deciding whether the expectation was legitimate or not, the Court may consider that the decision of the public authority has breached a legitimate expectation and, if it is proved, then the Court may annul the

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> decision and direct the concerned authority/person to live up to the legitimate expectation. This doctrine is basically applied as a tool to watch over the actions of administrative authorities and in essence imposes obligations on all public authorities to act fair and square in all matters encompassing legitimate expectation .... The doctrine of legitimate expectation is equated with "fairness" and "equity" which is a legitimate attribute of a public functionary. The justification for treating "legitimate expectation" and "promissory estoppel" together as grounds for judicial review is (i) that they both fall under the general head of "fairness"; and (ii) that "legitimate expectation" is akin to an estoppel." ...

4.3 OGRA's reply

4.3.1 Referring to paras 6.7 to 6.10 of the MFR-25 determination, OGRA replied that third-party damage was a sub-head of UFG, and had to remain within the allowed aggregate benchmark for UFG of 7.6%, that the claims under this sub-head had become recurring, that SSGC must mitigate them through monitoring and vigilance and recover its loss from those responsible and not from consumers, that SNGPL ran a network about three times larger but claimed nothing under this head, that the audit proved the volume but not prudent management practices, and that OGRA still allowed 50% as a lenient one-time measure to discourage the practice. Above all, it asserted that the FY-23 and FY-24 allowances set no precedent that all claims of third-party damage will be allowed as claimed year after year. The rationale is summarized in para 24 of its reply as follows:

> Accordingly, the determination reflects a balanced approach, allowing limited relief while ensuring that recurring and preventable losses are not imposed on consumers and are instead addressed through operational improvement, efficiency and recovery from responsible third parties rather than burdening the consumer with the same.

4.4 Analysis

4.4.1 OGRA is correct in treating the third-party damage claim as a sub-set of UFG claim. SSG is not correct in positing it as an independent head of claim. Given the order the claims are pleaded in the application, the broader discussion of UFG is deferred to the decision on the 4th and 5th claims.

4.4.2 The *Nadra* case cited by Mr. Zia concerned applicants for posts in NADRA who qualified for one set of posts but were offered other posts by NADRA. They accepted the offer, on a representation by NADRA that they would be appointed to the advertised posts on completion of one month on-job training, but that promise was breached. It was this factual context in which the doctrine of

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legitimate expectation was expounded upon and applied as 'akin to estoppel'. No such direct promise or representation has been demonstrated by SSG as having been made to them in the Ordinance, the Tariff Rules, or in any regulatory determination by OGRA. To the extent past practice forms the plank of SSG's argument, it is hard to see how a regulatory allowance for two years becomes a binding 'past practice', so as can never be deviated from.

4.4.3 The proper formulation of the doctrine of legitimate expectation, in fact the source of it, is in Lord Diplock's judgment in the seminal case titled *Council of Civil Service Unions and others vs Minister for the Civil Service* ((1984) 3 All ER 935), commonly referred to as the GCHQ case, cited by the Supreme Court in *Gadoon Textile Mills Limited and others vs WAPDA and others* (1997 SCMR 641) by reproducing the following paragraph from Lord Diplock's judgment:

> To qualify as a subject for judicial review the decision must have consequences which affect some person (or body of persons) other than the decision-maker, although it may affect him too. It must affect such other person either (a) by altering rights or obligations of that person which are enforceable by or against him in private law or (b) by depriving him of some benefit or advantage which either (i) he has in the past been permitted by the decision-maker to enjoy and which he can legitimately expect to be permitted to continue to do until there has been communicated to him some rational ground for withdrawing it on which he has been given an opportunity to comment, or (ii) he has received assurance from the decision-maker will not be withdrawn without giving him first an opportunity of advancing reasons for contending that they should not be withdrawn. I prefer to continue to call the kind of expectation that qualifies a decision for inclusion in clause (b) a 'legitimate expectation' rather than a 'reasonable expectation', in order thereby to indicate that it has consequences to which effect will be given in public law, whereas an expectation or hope that some benefit or advantage would continue to be enjoyed, although it might well be entertained by a 'reasonable' man, would not necessarily have such consequences.

4.4.4 The doctrine of legitimate expectation therefore requires a higher bar to be crossed than reasonableness of an expectation. SSG has not been able to show what assurance had ever been extended by OGRA in respect of the 3rd party damage head that enabled SSG to legitimately expect to continue without check. The reasoning given by OGRA is not irrational, nor contrary to the tariff evaluation criteria. In fact, OGRA could not have continued to allow third-party damage as claimed, year-after-year, without being in violation of the evaluation criteria and its function under section 6(2)(f) of the Ordinance pertaining to operational efficiency of its licensee. Perhaps, if the claim was disallowed in full

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in FRR-25, the legitimate expectation claim might have been on stronger footing. OGRA did not proceed neatly by requiring SSG to submit an 'actionable plan ensuring effective preventive and timely response' in respect of third-party damage instances *after* applying the prudence scissors, but as the cut was made for 50% and not the full sum, and the reasons were already communicated vide order dated 17.10.2025 (reference para 6.8 of the impugned decision), the decision is not "so unreasonable as no reasonable authority would make" for it to fail the tests of judicial review per *Asif Vardag case (supra).*

4.5 Order

For the reasons aforesaid, this 2nd claim for inclusion of the cost of gas lost to third-party damage is rejected.

5 3RD CLAIM: 1,890 MMCF AND 2,863 MMCF OF STOLEN PIPELINE GAS

5.1 The impugned decision

These volumes represent gas stolen from different areas from the gas transmission and distribution pipelines of SSG. OGRA disallowed the exclusion of the stolen volumes from the UFG allowance/benchmark.

5.2 SSG's case

5.2.1 Calling this disallowance as non-reading of evidence, unjust and unreasonable, Mr. Zia submitted that OGRA did not consider the actions taken by SSG, including FIRs registered and cases pursed; that OGRA wrongly added stolen gas in the UFG allowance, as the theft was not a result of operational weakness but due to third-party crime. He continued that it was impractical for SSG to watch and guard the entire length of over 55,000 km of pipelines. He added that stolen gas was not replenished in the relevant financial year through FIRs and court cases, and that the revenue requirement assurance dictated financial compensation in the year of the theft.

5.2.2 During the hearing, it transpired that a large quantum of theft was lost to an illegal tapping in a transmission line that continued undetected for 7 months. SSG claimed that, as the pressure in the transmission lines was extremely high[13],

[13] 1200 psi; compared with the household pressure of 30 psi

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the prolonged theft translated into a large volume lost over 7 months. On the Court's question as to how such theft remained undetected by the System Control & Data Acquisition System (SCADA), the Court was given presentations by SSG, the summary of which was that the stolen volume was below the 2% allowed variation between the intake and outflow meters measured by SCADA, and that SCADA mainly recorded sudden drops in pressure and not minor but steady loss. SSG informed the Court that it had planned to install new technologies and tools to curtail gas theft.

5.3 OGRA's reply

5.3.1 Mr. Manik for OGRA submitted that, with no new evidence provided in support of this claim in review, OGRA declined the review, reiterating that SSG must approach the police, pursue cases under Gas Theft Act 2016, and, maintaining FRR-25 findings, reiterated that the theft volumes would remain included in UFG benchmark.

5.3.2 In its written reply and written submissions, OGRA stated emphatically that theft was nothing but UFG, that the UFG benchmark already allows 18,096 MMCF for FY-25, and a separate head would defeat the benchmark. Theft went undetected for about 7 months on a dedicated right of way under patrolling duty and SCADA monitoring, which was a failure of vigilance and not an unavoidable loss.

5.4 Analysis

5.4.1 OGRA is correct in its stance that theft was nothing but UFG, a stance that cannot be disputed given the definition of UFG in the Tariff Rules (see section 6 of this judgment). SSG's sleight to pluck out sub-heads like third-party damage and gas theft from the UFG allowance/benchmark one-by-one, tends to rest on an implicit argument that UFG is meant to cover operational losses only, while remaining vague about what the word 'operational' is meant to cover in this context.

5.4.2 Stripped to its essence, SSG's claim is that the gas lost to theft is due to third-party criminal conduct, and not due to SSG's operational inefficiency, and it cannot be made to bear the corresponding financial loss.

5.4.3 SSG's stance is specious. It is one of the dimensions of operational efficiency to counter theft of one's business assets and property. To draw an analogy, it would be indefensible for a bank with hundreds of branches to deny its customers their

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deposits because of a heist in one branch due to inadequate security measures at that branch. The argument fails because it runs counter to generally accepted business practices of a business being responsible for the security of its assets. It cuts no ice that the theft was undetectable for a long time; this 'penny shaving'[14] argument is spurious logic.

5.4.4 Rule 17(1)(c) of the Tariff Rules, stipulating penalties for failure to achieve benchmarks set by OGRA, caters to OGRA's stance on this claim.

5.4.5 Clause 32.1 of SSG's license obligates SSG to patrol the transmission pipelines right of way "…*to observe factors affecting the safe operation of the transmission system…".*

5.4.6 In regulatory jurisprudence, a guaranteed return by no means carries an implied promise by the regulator that theft would be compensated. Perhaps an extreme break down of law and order over an extended period may give sufficient reason for a regulator to make concessions to prevent utility insolvency, but certainly not so in the ordinary course.

5.4.7 No submissions were heard as to why such loss wasn't insured by SSG, and whether the cost of insurance under this head is a cost that the regulator might consider passing on in tariffs. Now that an 'action plan' is called by the regulator, perhaps this aspect will also be considered.

5.5 Order

For the foregoing reasons, this 3rd claim fails.

6 4TH AND 5TH CLAIMS: UFG ALLOWANCE ON GAS TRANSPORTED FOR K-ELECTRIC; BUNDLED UFG BENCHMARK

6.1 UFG Benchmark

6.1.1 UFG is defined by rule 2(1)(m) of the Tariff Rules as follows:

> "unaccounted for natural gas" means, in respect of a financial year, the difference between the total volume of metered gas received by a licensee during the financial year and the volume of natural gas metered as having been delivered by the licensee to its consumers excluding therefrom metered natural

[14] See the Hock Hua Bank (Malaysia) — The "One Cent Thief" Case

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> gas used for self-consumption by the licensee for the purposes of its regulated activity; and such other quantity as may be allowed by the Authority for use by the licensee in the operation and maintenance of its regulated activity.

6.1.2 Simplified, it means the net sum of the inflow meter readings minus outflow meter readings, less self-consumption, plus additional UFG allowances if allowed by the regulator. Regulator-allowed additional allowances, however, are restricted to the operations and maintenance activities and circumstances of SSG. This is how the definition reads.

6.2 The Impugned Decision

6.2.1 On the K-Electric sale volume, OGRA maintained the decision in FRR-25 determination and excluded the KE sale gas volume from SSG's distribution business segment, placing it exclusively in the transmission business segment. It was an admitted position that the KE gas was delivered to KE solely on the transmission network. Resultantly, only the transmission UFG benchmark applied for the KE sale gas volumes.

6.2.2 On the bundled versus unbundled UFG benchmark issue, the impugned MFR-25 determination maintained the FRR-25 determination of unbundled UFG benchmarks for the transmission and distribution networks.

6.3 SSG's case

6.3.1 In relation to the exclusion of K-Electric sale losses from the UFG benchmark for distribution and inclusion in the transmission UFG benchmark, Mr. Zia in his written submissions stated that, currently, the tariff framework is applied on bundled basis for transmission and distribution networks. SSG transported 33,233 MMCF of gas for KE on wheeling basis in FY-25, under OGRA Gas (Third Party Access) Rules, 2018. He said that KE gas commingles with all other gases in the network and, to deliver the agreed volume of gas to KE in energy equivalence terms, it had to allocate a higher loss margin from its distribution losses.

6.3.2 In relation to the application of an unbundled UFG benchmark, he submitted that the definition of UFG per rule 2(1)(m) of the Tariff Rules does not contemplate unbundled UFG benchmarks. He added that SSG presently operates under bundled/integrated regime, that annual revenues and tariffs are determined on bundled basis, and that, since no separate tariffs were prescribed for transmission

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and distribution systems, so UFG allowance/benchmark should also remain bundled. He submitted that unbundling UFG benchmarks without corresponding adjustments in tariffs and subsidies causes undue loss to SSG.

6.3.3 Claiming legitimate expectation again, he maintained that the UFG benchmark was applied on bundled basis for the FRR determinations for 2023 and 2024, that was tantamount to abandonment by OGRA of unbundled UFG benchmarks, and that unbundled benchmarks could not be resurrected and reapplied by OGRA for the FRR-25 determination.

6.4 OGRA's reply

6.4.1 Citing clause 21.1 of SSG's licence, OGRA's written reply states that OGRA is expressly empowered to fix separate benchmarks for the distinct regulated activities of transmission and distribution, pursuant to which UFG benchmarks are set periodically by OGRA in consultation with experts and licensees. OGRA states in its written reply that it had established separate UFG benchmarks for transmission (0.14%) and distribution (5% + 2.6%), based on a long benchmark-setting history since 2017. The reply states:

> 10 OGRA conducted a UFG study through M/s KPMG Taseer Hadi & Co., pursuant to which a UFG benchmark of (5% fixed, technical component + 2.6% local condition allowance linked with achievements against 30KMIs) was implemented for a five-year period from FY 2017–18 to FY 2021–22. By FY 2022–23, as the earlier study period had concluded and OGRA continued the existing benchmark with segregation between transmission and distribution, as per the Licence Condition 21.1. OGRA, has initiated the process for a subsequent study that is currently underway.
>
> 11 In terms of Licence Condition 21.2 read with Licence Condition 21.3, only such UFG as falls within the prescribed benchmark is allowable for the purposes of revenue requirement. Where the licensee maintains UFG within the prescribed limits, it is entitled to retain efficiency gains. Conversely, any UFG in excess of the prescribed benchmark is attributable to inefficiency and is required to be borne by the licensee and cannot be passed on to consumers. …
>
> 12 OGRA has already initiated a process through published Terms of Reference for determination of UFG benchmarks for the next five (5) years, wherein technical concerns raised by licensees in previous years are being duly evaluated, including, inter alia, unified versus segregated benchmarks, treatment of different volumes in different systems, and analysis of key UFG components. The same shall be addressed appropriately based on technical recommendations and impact assessment in line with international best practices based on expert recommendations.

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6.4.2 OGRA states in its written reply that it had established separate UFG benchmarks for transmission (0.14%) and distribution (5% + 2.6%). For distribution, the base 5% was inclusive of losses for metering error, theft, and leakages. The additional 2.6% was for non-consumer theft, law and order, and other miscellaneous heads, and was linked to operational performance KPIs.

6.5 Analysis

6.5.1 On the unbundled UFG benchmark issue, answering the Court's questions, SSG's representatives presented that there were 28 POD[15] meters measuring SSG system intake from the gas fields, to be taken as 'input meters', and millions of consumer meters, to be taken as 'output meters', and, per UFG definition in rule 2(1)(m), the UFG can only be the aggregate measurement of input meters minus the aggregate measurement of output meters, and that any intermediate stage losses in the network could not be taken on their own for UFG benchmark setting purposes.

6.5.2 SSG operates under a license issued by OGRA under Chapter IV of the Ordinance. The license was issued on 03.09.2003, for 30 years. It is an integrated license, in that SSG was given the license to engage in the 'regulated activities', which are separately defined as 'transmission' and 'distribution' on the cover page of the license. That cover page is followed by three sets of conditions: general conditions, conditions specific to transmission, and conditions specific to distribution.

6.5.3 Clause 8.1 of SSG's licence reads:

> **8. Separate Accounts for Regulated Activities**
>
> 8.1 Commencing from first July 2005 or any other date approved by the Authority on an application by the Licensee, the Licensee shall keep proper books of accounts and records separately for transmission, distribution and sale of natural gas in such form as may be prescribed by the Authority.

6.5.4 Clause 21 of the license reads as follows:

> **21. Unaccounted for Gas (UFG)**
>
> 21.1 The Licensee shall take all possible steps to keep the UFG within

[15] Point of delivery

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> acceptable limits. The Authority for this purpose, in consultation with Licensee and experts, shall fix target of UFG for each financial year. The Authority may fix UFG targets separately for each regulated activity.
>
> 2.1.2 The Licensee shall be entitled to claim the UFG to the extent of target fixed by the Authority under 21.1 for the purpose of determining its requirement for each financial year.
>
> 21.3 In case the Licensee improves upon the UFG target prescribed by the Authority under Condition 21.1 for any financial year, the Licensee shall be entitled to retain the gain on that account. Conversely if the Licensee fails to meet the UFG target the loss on that account shall be borne by the Licensee and shall not form part of its total revenue requirement.

6.5.5 The argument that KE gas commingles with all other gases in the 'network' and, to deliver the agreed volume of gas to KE, a higher loss margin from its distribution losses must be allocated, is a sleight. Admittedly, the delivery to KE is on the transmission network alone. Admittedly, in the contract between SSG and KE, an agreed loss margin is already given to SSG. This question was expressly put to SSG and was answered as above. It was not answered why should it claim a higher loss margin for the same quantity of gas by reference to its distribution network losses when, admittedly, the KE volume is delivered on the transmission network and not on the distribution network. The argument is rather disingenuous and does not merit acceptance.

6.5.6 The transportation loss is an agreed number in third-party network access contracts and, knowing its system, SSG qua the access provider negotiates its transportation loss margins directly with KE. Transportation charge is a pre-agreed cost to the third-party access seeker, and not a charge on retail consumers. SGS's argument that it has to deliver a higher volume of gas than received due to co-mingling of lower BTU gases with the high BTU gases to maintain the 'energy equivalence' of delivered gas quantities to KE, is an argument that belongs to the negotiations over the pricing of access arrangements, and not before OGRA nor the High Court to enable it to get an extra allowance by borrowing from its distribution segment benchmark UFG, especially when, in actual fact, the distribution segment has no role in the KE access arrangement.

6.5.7 As for SGS's argument that its tariffs are determined on a bundled basis and the application of unbundled UFG benchmarks was inconsistent in approach and outcome, it was never shown what impediment, if any, was there for SSG itself to apply to OGRA for unbundled tariffs for its transportation and distribution

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segments, for which it is required to maintain separate accounts anyway under its license. Perhaps unbundled tariffs will not be to its overall advantage. Unless these questions are answered, it is spurious for SSG to complain as it does when it accepted a license that expressly subjected it to observe unbundled UFG benchmarks determined by OGRA.

6.5.8 SGS's argument that no intermediate readings of the internal system losses are to be taken into consideration flows from a logical error of selective attention. Looked at the right way, OGRA applies benchmarks as transmission 0.14%, and distribution at 5% + 2.6%. Added together, they come to 7.74%. Rule 2(1)(m) is not to be read alone; it is to be read with rule 17(1)(c) (benchmark-based tariff setting), and with license condition 21 stipulating that OGRA may fix UFG targets separately for each regulated activity. So, to answer this argument, the number for the purposes of rule 2(1)(m) is 7.74%; rule 2(1)(m) does not prevent this number being sub-divided into 0.14%, 5% and 2.6%.

6.5.9 Mr. Zia's submission that no consultation was held with SSG, as required under license condition 21.1, before setting the UFG benchmarks cannot be accepted on the basis of the record, for it implies that OGRA and SSG never engaged in deep discussions of what the benchmarks should be; not whether they would be bundled or unbundled, for that point is no longer open for discussion, but what would the unbundled UFG benchmarks be for each regulated activity. The UFG benchmark determination is a crucial decision, and this Court cannot accept that no consultation was held with SSG at all before setting the above UFG benchmarks. OGRA's reply mentions a detailed study preceding the current benchmarks coupled with consultations (para 6.4.1). To the extent the argument is that, since an unbundled UFG benchmark was not applied in the FRR-24 determination, it somehow constituted an irrevocable representation that it would never be applied again, then this argument also fails for the reasoning given for claim no. 2 that no legitimate expectation can be asserted in such circumstances without an express representation by the regulator.

6.6 Order

6.6.1 The license conditions, issued in 2003, and the history of UFG benchmark setting exercise, show that it is an iterative process. A benchmark set at one point can be revisited by the regulator, even at the instance of the utility for good reasons.

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6.6.2 Based on the record, the submissions, and the analysis above, it is concluded that unbundled UFG benchmarks are consistent with the law and SSG's license.

6.6.3 As OGRA has already commenced a new benchmark setting exercise, it is not appropriate for this Court to intervene at this stage. SSG can make its case before OGRA. Given the crucial importance of UFG benchmarks, OGRA is directed to complete the exercise within a reasonable time, preferably within three months of receiving a certified copy of this judgment.

7 6TH CLAIM: UFG BENCHMARK OF 0.14% ON TRANSMISSION NETWORK

7.1 SSG's case

7.1.1 SSG complains that the transmission benchmark UFG cannot be 0.14% of the gas transported in its transmission network; that this number was fixed without any technical basis; that OGRA's reliance on ECC Decision of 2016 justifying these numbers was erroneous because that decision was meant for RLNG supplies through a dedicated line; and that OGRA arbitrarily determined a consolidated UFG benchmark of 0.50% for the full transmission networks of both SSGC and SNGPL.

7.2 OGRA's reply

7.2.1 OGRA replied that this benchmark was in force since ERR-23, and was never challenged by SSG; that SSG's transmission UFG was *actually* below 0.14% for the last three years per the data submitted to OGRA; that SSG cannot approbate and reprobate: it kept the full 0.14% despite lower UFG as efficiency gain for three years and attacks the benchmark only now when it is not met.

7.3 Analysis

7.3.1 SSG is mounting the challenge on the benchmark number, when, on the record, it is demonstrated that SSG had proceeded for many years on the basis that the benchmarks were in vogue, even though it might not have agreed with them. If not satisfied, it should have contested the benchmarks as a stand-alone issue, rather than as one embedded in any given year's tariff. It had to fully understand what regulatory benchmarks have been set, and if it did not agree therewith, then it ought to have contested them in their own right to the highest forum, if it really

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had a case. But to question those benchmarks settled in earlier determinations collaterally in this application sets no limits to the uncertainty that might result. The benchmark, admittedly used first in FRR-23 was accepted by SSG. Why it should not be estopped from resiling is the counter-argument to its assertion of a legitimate expectation premised only on one-year's omission to apply the benchmark in FRR-24.

7.4 Order

As OGRA has already commenced a new benchmark setting exercise, it is not appropriate for this Court to intervene at this stage. SSG can make its case before OGRA. Given the crucial importance of UFG benchmarks, OGRA is directed to complete the exercise within a reasonable time, preferably within three months of receiving a certified copy of this judgment.

8 7TH CLAIM: RLNG VOLUME HANDLING IMPACT ON UFG

8.1 SSG's case

This claim is that SSG must provide 'energy equivalence' to RLNG consumers by supplying them additional gas, but OGRA did not allow this as an exclusion from the UFG benchmark. RLNG has a higher heating value than indigenous gas, and their commingling in the pipeline system alters the average heating value to a lower number, and, as SSG must provide energy equivalence to RLNG consumers, it has to supply them additional gas. It claimed that compensatory additional gas volumes were allowed in past years but now some of these were disallowed.

8.2 OGRA's reply

OGRA replied that an independent audit was held for FY-24, which found no RLNG impact on the UFG. OGRA had already rejected the technical basis of this claim in FRR-24. No new evidence had been brought by SSG for OGRA to reconsider its FRR-25 determination on this point.

8.3 Analysis

8.3.1 This claim is another subsidiary issue for setting the UFG benchmarks. So far we have seen several subsidiary issues, starting from transportation losses in the transmission and distribution networks, third-party damage, theft, heating value

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equivalence caused by commingling, generally and with RLNG, and the list may go on.

8.3.2 These subsidiary questions, as noted above, require a self-contained determination by OGRA, preferably followed by regulations. This Court, sitting in a jurisdiction akin to judicial review, will not substitute its uninformed judgment on a matter that requires a wide variety of technical, financial, and other evidence to be led before the regulator for it to render a reasoned and speaking order on all the subsidiary issues, as it were, in the first instance.

8.3.3 Judicial review is a discretionary remedy. Based on the foregoing reasoning, I conclude that the discretion here is better exercised by directing SSG to participate actively in the upcoming UFG benchmark determination exercise that OGRA represented to the Court was underway.

8.4 Order

As OGRA has already commenced a new benchmark setting exercise, it is not appropriate for this Court to intervene at this stage. SSG can make its case before OGRA. Given the crucial importance of UFG benchmarks, OGRA is directed to complete the exercise within a reasonable time, preferably within three months of receiving a certified copy of this judgment.

9 CONCLUSION

9.1 The application is allowed in part per the order for the 1st claim. The orders for the remaining claims are as stated for the respective claims.

9.2 Disposed of.

(Sardar Ejaz Ishaq Khan)
Judge

Announced in open Court on **13.11.2026**.

Judge

Imran

Approved for reporting.

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10 ANNEX – AFUDC (*BONBRIGHT*)

AFUDC Versus CWIP

Two Methods, FERC and other jurisdictions recognize that there are two alternate regulatory practices by which these carrying charges of debt interest and reasonable equity return on construction capital are recovered in rates. One method capitalizes the carrying charges incurred during the construction period as allowance for funds used during construction (AFUDC). AFUDC is recorded part as current income, part as an offset to interest expenses, but no cash payments are made by ratepayers during construction. The payments from ratepayers to recover the carrying charges begin when the completed plant goes on stream. The entire cost of the plant (including AFUDC) is added to rate base, and it earns a rate of return on investment and is depreciated over the life of that plant. The second method is to include construction work in progress (CWIP) in the rate base. (CWIP includes accrued AFUDC on investment not in rate base.) The regulatee recovers its carrying charges currently from ratepayers through the return component of its rates, rather than adding them to the cost of construction for recovery when the plant is in service. The return on CWIP is recorded as income on a current basis (like AFUDC), and actual cash payments are made by the ratepayers currently (unlike AFUDC).

Although each method is intended to provide an opportunity to recover the carrying charges, they differ primarily according to when the investment is permitted in rate base, i.e., when the carrying charges are reflected in the cost of service and thus in rates charged to ratepayers. The courts generally defer to the regulatory agency's choice of methods.

In a rate base measured by original cost, there would be no occasion for an allowance for funds used during construction if capital devoted by the company to the public service were given an opportunity to enjoy a fair rate of return from the very moment of its investment. Some commissions have granted this opportunity by including directly in the rate base amounts expended on work still under construction, CWIP, and hence not yet rendering public service. Historically, it was felt that unless these CWIP amounts were relatively small compared to the investments in completed plant- which for recent nuclear plants they most certainly are not- their immediate inclusion in the rate base would be a departure from the general principle that the public utility consumers in any given year should pay a return only on the cost of those assets that are performing for them a useful service. In any event, the general practice historically was to withhold from the rate base major plant construction costs until the plant itself has become part of the "used and useful" property.

As long as this withholding practice existed, there arose a need for some ratemaking provision whereby the company might eventually receive an adequate compensation for its advance commitment of capital. The standard provision of this nature, and the one that traditionally was believed to be most satisfactory, at least as long as the company could maintain its financial integrity, and except in circumstances where the stability and predictability of rates and revenues became a major issue, was that of a computed allowance for funds used during construction, or AFUDC as it is commonly known. However, this allowance should not be restricted to the interest on debentures, if any, that the company may pay on loans designed to finance the construction work, but should also include a fair return on the equity capital required to support the debt instruments.

So far as we know, the propriety of some allowance of this type as a component of the rate base has been conceded by all commissions. But, the standard was once challenged by the FPC, which insisted that the allowed rate of interest should be limited to the low contract rates payable on borrowed funds instead of being set at rates, typical of the usual fair rate of return. The staff

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even intimated that, on grounds of accounting principles, the compensation payable to companies for their commitment of capital in advance of any claim to a fair return should take the form of later enhancements in the allowed rate of return instead of taking the form of enhancements in the rate base. The relevant accounting principles were found to lie in the strict adherence of orthodox fixed-asset accounting to the principle of cost. While the failure of a company to earn any return on capital embodied in work in progress was conceded to justify more liberal later allowances of opportunities to make a profit, it was held not to constitute a "cost" in an accurate sense, at least not in any sense recognized in financial accounting.

This attempt by the Commission's experts to judge the merits of a practical rule of rate control by an appeal to "generally acceptable principles of accounting" gave some representatives for the utility companies a dose of their own medicine. We refer particularly to attempts by expert witnesses for public utility companies to invoke "generally accepted principles of accounting" in support of the recognition of "acquisition costs" rather than of "aboriginal costs" as components of the rate base. Both sides in rate-case disputes have a tendency to find these "accepted principles" relevant when, but only when, they comport with whatever rules of ratemaking they favor in the case at bar.

In 1971 the FPC started using the term "allowance for funds used during construction" instead of "interest during construction" on its accounting system (its Uniform System of Accounts began January 1, 1937). The Commission developed a formula for the maximum AFUDC that includes both the net cost of borrowed funds used for construction and a reasonable rate on other funds when so used (Johnson, 1977). According to Phillips (1984, p. 323):

> Under the formula, the embedded book-cost rates for the prior year are used for debt and preferred stock, while the cost rate for common equity "shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdiction. If such cost rate is not available, the average rate actually earned during the preceding three years shall be used." Further, since 1977, AFUDC has been segregated into two component parts borrowed funds and other funds. The former have been assigned to the "interest charges" section of the income statement; the latter remain in the "other income and deductions" section.

FPC Order No. 561 (1977): AFUDC. In February 1977, the FPC issued Order 561 establishing a uniform formulary method of determining the maximum rates to be used in computing AFUDC. The primary objective of the order was to establish a method which would give recognition to the interrelationship between capital utilized for rate case purposes and the capital components of AFUDC in a manner which would permit a utility to achieve a rate of return on its total utility operations at approximately the rate which would be allowed in a rate case. Order 561 established a uniform formula method of determining the maximum allowable AFUDC rate. The formula assumes that short-term debt is the first source of funds for construction, with the remainder financed from long-term debt, preferred stock and common equity. The embedded book cost rates are used for debt and preferred stock, while the rate allowed in the last primary rate proceeding is used for common equity. The FPC order also provided for semi-annual compounding of AFUDC. The primary purpose of AFUDC is to capitalize the costs of financing construction, separate the effects of the construction program from current operations, and to allocate current capital costs to future periods when these capital facilities are producing revenue. FPC Order No. 561 has been adopted by most state regulatory commissions as the method for computing AFUDC.

The Commission's original position seems quite unconvincing, since it had little or no bearing on the question of whether the provisions for compensation on capital that was tied up in work under construction should take the form of a rate-base enhancement or of a rate-of-return

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enhancement. Here, we think standard procedure is wise in accepting the former alternative, and for reasons quite apart from the academic question whether the AFUDC---called "phantom income" by Business Week (1980) and "funny money"-- by others is regarded as a recordation of an actual cost or, alternatively, as the allowance of a credit to the corporation for temporary denial of opportunity to earn a return on cost.

However, in our opinion, the latter interpretation is correct, since a failure to earn any return on the cost of a capital asset is not in itself a cost in a strict sense. As to the proposal to disallow rate-base enhancements in favor of a more liberal fair rate of return, this would impose upon those people who must calculate the proper percentage rate the obligation of attempting to do indirectly, and without benefit of adequate accounting data, what the overt allowances for funds used during construction do directly and systematically. Anyone who has faced the difficult problem of establishing a fair rate of return or of estimating the cost of capital can hardly welcome a change in the rules of rate-base determination that would needlessly add to their difficulties.

As to the question whether the AFUDC should be based on percentage rates approximating contract interest on secure loans, or whether it should be based on a higher rate approximating an accepted fair rate of return, the answer should depend on the answer to the further question: "Which rate comes closer to reflecting the time discount that the investment market places on investments on which the anticipated return is subject to a material delay, as compared to investments that promise immediate income?" The well-recognized market preference for early, and hence less uncertain, realization strongly suggests the allowance of a time discount not lower than that reflected by a standard fair rate of return. There is no question of the growing and grave importance of AFUDC. Makhija and Thompson (1986) show that AFUDC as a percent of net income for Moody's 24 utilities went from only 7.8 percent in 1967 to 51.4 percent in 1983 (with a high of 51.6 percent in 1982).

Controversy: Howe and Rasmussen (1982, p. 92) summarize the present sound and fury surrounding how company funds committed prior to a plant going on stream should be handled:

> One of the more controversial rate-base issues has been whether or not to include construction work in progress in the rate base. Construction work in progress (or CWIP) is the investment in plant under construction. Its inclusion can lead to a mismatch of rate base with revenues and expenses and to the inclusion of property not used and useful in the rate base. Some jurisdictions have included CWIP in rate bases. Others follow more traditional ratemaking and do not include CWIP. The allowance for funds used during construction has been developed to permit the capital costs the utility has during the construction period to be compensated by the future consumer actually to be served by the plant under construction. The cost of capital used in financing the construction is capitalized, i.e., the original cost of the plant recorded on the utility's books includes capital charges and other overheads, The Federal Energy Regulatory Commission provides in its uniform system of accounts that the costs of short-term debt should be applied to construction first. If the short-term debt is not sufficient to cover the amount of construction work in progress, the weighted cost of long-term financing is then applied to the remaining amount of construction.
>
> The use of an allowance for funds used during construction is less costly than is construction work in progress. An allowance for funds used during construction does not produce taxable income to the utility. Rather, the taxable income results in higher book depreciation charges and more earnings in later years when the plant is used and useful. Allowing a return on construction work in progress does create taxable income, on the other hand. As a result, $1 of equity return earned on construction work in progress increases the cost of service by $2. A tax deferral accompanies the allowance for funds used during construction, which makes this method of recovering capital costs during

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construction less costly than the inclusion of construction work in progress in the rate base.

Despite one's position on the dispute on CWIP versus AFUDC, it is apparent that because of the hard times confronting utilities in the 1980s---involving significant cash flow, earnings, and coverage ratio problems---many state and federal commissions began to allow part or all of CWIP in the rate base in varying amounts and under varying conditions (see Phillips, 1984, pp. 324-325 for details). The decision whether to include CWIP in the rate base becomes very crucial when a commission decides to cancel a plant. If CWIP is not allowed in the rate base, consistency calls for not including the amortized balance in the rate base (Urban, 1984). If CWIP were allowed in the rate base, consistency suggests inclusion of the unamortized balance as well. Also, commissions differ on the treatment of AFUIDC. A remedy for plant cancellation that is more favorable to the utility (ratepayer) would include a short (long) CWIP amortization period, inclusion (exclusion) of the unamortized portion of CWIP in the rate base, and inclusion (disallowance) of AFUDC in the rate base.

It is an unsettled issue in public utilities whether CWIP in the rate base is preferred although Morin (1986) presents a lucid case for CWIP inclusion based on a simulation model. He finds that CWIP inclusion benefits ratepayers by lowering the costs of both debt and equity capital and by lowering rates over the lifetime of the plant as the rate base is not permanently enhanced by the amount of financing costs accrued during construction.

On the other hand, Makhija and Thompson (1986) found ratepayers may prefer either approach. When the AFUDC rate is large and growth is slow, the ratepayer will prefer CWIP in the rate base. As growth decreases, the benefits of CWIP decline. The shareholders prefer CWIP if the AFUDC rate is low and growth is rapid. When the AFUDC rate is intermediate somewhere between large and small, the shareholders and ratepayers both may prefer AFUDC regulation. They believe that if there are any benefits to ratepayers from CWIP, it is from reduced revenue requests. Because many states set an arbitrary rate in calculating AFUDC that is far below the cost of capital, investors (ratepayers) prefer (don't prefer) CWIP in the rate base. In their opinion, most of the reason people want CWIP in the rate base is because the AFUDC rate is too low and it is politically easier to get increased earnings from CWIP inclusion than from rate increases.

The conditions for inclusion and the amounts allowed for CWIP in the rate base vary considerably by jurisdiction. As of 1978, 34 state regulatory commissions allowed CWIP under both broad and narrow (as was true of FERC) conditions (Muhs & Schauer, 1980). The number of inclusion states has increased rapidly in recent years.

FERC Order No. 298 (1983): CWIP. The FERC's historic policy regarding CWIP generally prohibited inclusion of CWIP in rate base until the facility became "used and useful." In 1976, the FPC promulgated regulations (Order 555) that provided three exceptions: (1) for construction of pollution control facilities; (2) for construction of fuel conversion facilities; and (3) for certain other situations where the utility is in severe financial difficulty which could not otherwise be alleviated without materially increasing the cost of electricity to consumers.

On May 16, 1983, the FERC issued new regulations on the treatment of FERC jurisdictional CWIP (Order No. 298). Order 298 permits any public utility regulated by the FERC to file to include in rate base up to 50 percent of jurisdictionally allowable CWIP. This would be subject to a two-year impact limitation of 6 percent per year on the wholesale rate increase attributable to the inclusion of CWIP Order 298 supplements existing regulations which provide for inclusion in rate base of 100 percent of jurisdictionally allowable CWIP associated with pollution control and fuel conversion facilities.

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Order 298 results in the use of both CWIP in rate base and AFUDC. CWIP costs not put in the rate base are given AFUDC treatment. It also provides that public utilities are eligible to file to include CWIP in rate base irrespective of their financial condition.

The regulations contain new filing requirements that will enable the FERC to evaluate the prudence of the claimed costs, including the extent to which the investment is a part of a least cost power supply strategy. They also allow wholesale customers to escape liability for CWIP if they can prove that they bear no responsibility for the decision to build a new plant and will, in fact, purchase no full or partial firm power requirements which involve the new plant.

These regulations cover only the share of the facility which is to provide FERC jurisdictional power. The regulations do not directly affect how state public utility commissions elect to treat state jurisdictional CWIP. Some states such as Wisconsin, allow some CWIP and allow some AFUDC on the proportion of CWIP not allowed in the rate base. FERC has given this mixed approach some consideration.

Two sharply divergent views of the electric utility industry emerged from the comments concerning Order 298. According to privately owned utility companies, the industry has been (and remains) in difficult financial straits, which raises serious questions as to the industry's ability to finance today the construction of electrical generation capacity which will be needed later this decade and beyond. Under this view, utilities' inability to earn their allowed rate of return reduces current cash flow, tending to increase the need for additional external financing. This tends in turn to increase risk and thereby to increase the actual cost of capital. These factors then tend to jeopardize the industry's ability to finance the major new facilities which the industry forecasts are needed to replace inefficient existing facilities and to satisfy increased consumer demand.

These financial constraints are said to have caused the cancellation and deferral of substantial new capacity over the past few years. Financial concerns also have tended to bias the industry's investment in favor of smaller facilities which may require less construction capital, but which are more costly to consumers in the long run because of higher fuel and maintenance costs.

The utilities' wholesale power customers present a different view. They recognize that the utility industry has faced financial difficulties over the last few years, but say that the situation has brightened as state regulatory commissions have recognized the need for higher rates. Moreover, they claim that the extensive cancellations and deferrals of new capacity reflect a belated recognition of sharply reduced growth in electricity demand, and the utilities' inability to obtain adequate financing. The ratepayers thus oppose the inclusion of CWIP in rate base as an unnecessary and unduly costly answer to yesterday's problem. They recommend strongly against the inclusion of any CWIP in rate base.

The Commission took an intermediate view of the situation. The rule attempted to strike a balance between the competing views and takes a modest step at tying supply and demand together in a somewhat clearer fashion. The purpose of the rule is thus threefold:

(1) to mitigate any bias which may discourage additional capital investment in needed facilities;

(2) to enable the need for those facilities to be more accurately evaluated by price signals which reflect today some of the costs associated with future facilities; and

(3) to mitigate the sudden price increases which tend to result under an AFUDC policy thereby furthering the goal of rate stability.

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The current treatment adopted by several state regulators is to not allow CWIP in rate base, but to allow accrual of AFUDC. However, in the future, many utilities may require rate base inclusion of CWIP before beginning large construction projects because of increased uncertainty over recoverability of plant costs.

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