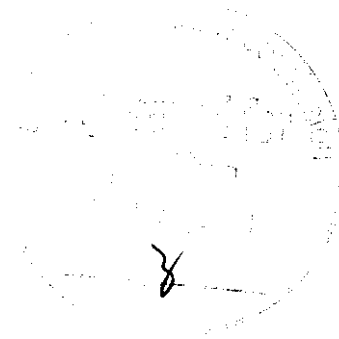


Republic of the Philippines
ENERGY REGULATORY COMMISSION
San Miguel Avenue, Pasig City

IN THE MATTER OF THE
APPLICATION FOR THE
APPROVAL OF THE SALE OF
SUBTRANSMISSION LINES /
ASSETS WITHIN THE FRANCHISE
AREA OF DAGUPAN ELECTRIC
CORPORATION (DECORP)



ERC CASE NO. 2007-518 MC

NATIONAL TRANSMISSION
CORPORATION (TRANSCO),
Applicant.

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RECEIVED
Date: OCT 29 2008
[Signature]

DECISION

Before this Commission for resolution is the application filed by the National Transmission Corporation (TRANSCO) on November 22, 2007 for approval of the sale of its subtransmission lines/assets within the franchise area of Dagupan Electric Corporation (DECORP).

Having found said application sufficient in form and in substance with the required fees having been paid, an Order and a Notice of Public Hearing, both dated December 20, 2007, were issued setting the case for initial hearing on February 14, 2008.

TRANSCO was directed to cause the publication of the Notice of Public Hearing, at its own expense, once (1x) in a newspaper of general circulation in the Philippines, at least ten (10) days before the date of the scheduled initial hearing.

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The Office of the Solicitor General (OSG), the Commission on Audit (COA) and the Committees on Energy of both Houses of Congress were furnished with copies of the Order and the Notice of Public Hearing and were requested to have their respective duly authorized representatives present at the aforesaid initial hearing.

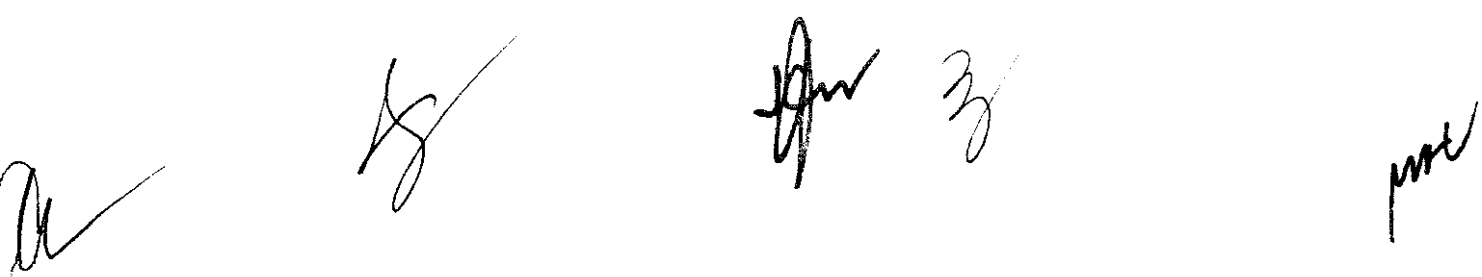
Likewise, the Offices of the Mayors of the Cities and Municipalities within DECORP's franchise area were furnished with copies of the Order and the Notice of Public Hearing for the appropriate posting thereof on their respective bulletin boards.

On February 13, 2008, TRANSCO filed its "Pre-Trial Brief".

During the initial hearing on February 14, 2007, TRANSCO and DECORP appeared. No oppositor/intervenor appeared nor was there any opposition/intervention registered.

In the said hearing, TRANSCO submitted its "Partial Compliance" with the jurisdictional requirements, which were provisionally admitted pending its completion, and committed to submit the remaining requirements in the next scheduled hearing.

On April 16, 2008, DECORP filed its "Pre-Trial Brief" while on April 24, 2008, TRANSCO re-filed its "Pre-Trial Brief" in compliance with the Commission's directive.

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At the continuation of the hearing on April 21, 2008, TRANSCO presented additional proofs of compliance with the Commission's publication and posting of notice requirements. There were still certifications from several municipalities that were lacking and thus, TRANSCO was directed to submit the same. Thereafter, TRANSCO and DECORP presented the following witnesses: 1) Mr. Renato B. Apilado, Corporate Staff Officer for Subtransmission Divestment Department (STDD) of TRANSCO, who testified on the procedure conducted in evaluating the qualification of DECORP to purchase the subtransmission assets; 2) Engr. Augusto D. Sarmiento, Network Operations Manager of DECORP, who testified on the subtransmission assets subject of the sale and on the execution of the Contract to Sell between TRANSCO and DECORP; and 3) Ms. Lilian D. Saralde, Finance Manager of DECORP, who testified on the acquisition cost of the subtransmission assets and financial capability of DECORP to acquire such assets. In the course of the direct examinations, various documents were identified and marked as exhibits. At the termination of the direct examinations, the Commission propounded clarificatory questions.

On April 23, 2008, DECORP filed its "Formal Offer of Exhibits".

On May 5, 2008, TRANSCO filed a "Motion for Extension to File Compliance and Formal Offer of Evidence" praying for additional fifteen (15) days or until May 20, 2008 within which to file its "Compliance" and "Formal Offer of Evidence".

On June 23, 2008, TRANSCO filed its "Compliance" with the other jurisdictional requirements required by the Commission.



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On August 15, 2008, the Commission issued another Order directing TRANSCO to file its formal offer of exhibits. In compliance therewith, on September 11, 2008, TRANSCO filed its "Formal Offer of Evidence".

The "Formal Offers of Exhibits/Evidence" filed by TRANSCO and DECORP, are hereby admitted for being relevant and material to the final resolution of this application.

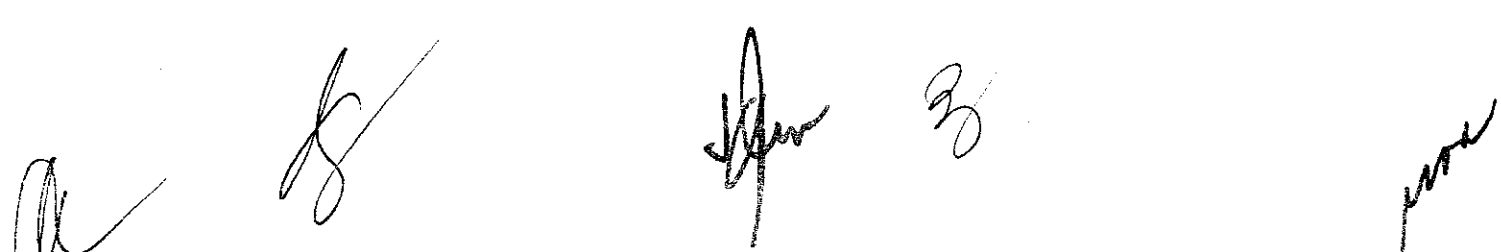
DISCUSSION AND EVALUATION

A. SUBTRANSMISSION ASSETS FOR SALE TO DECORP

Subtransmission Assets	Length (km.)	Year Energized	Structure (Qty)
1. Labrador- Binmaley L2 69 kV Line 2, inclusive of air break switch and cost of additional improvements	16.60	1998	151
2. Binmaley-Calasiao 69 kV Line, inclusive of cost of additional improvements	7.46	1975	86

B. CLASSIFICATION OF SUBTRANSMISSION ASSETS FOR DISPOSAL

The documents submitted by TRANSCO, particularly, the single line diagram serving the franchise area of DECORP showed that the subject subtransmission assets met the technical and functional criteria that distinguish transmission assets from subtransmission assets as established in Section 4, Rule 6 of the Implementing Rules and Regulations (IRR) of Republic Act No. 9136 and Section 2, Article III of the "Guidelines to the Sale and Transfer of the TransCo's Sub-transmission Assets and Franchising of Qualified Consortiums".



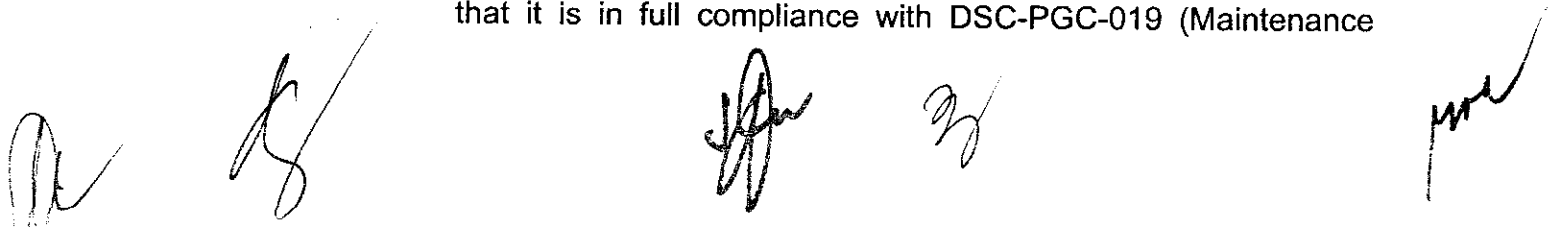
C. DETERMINATION OF CONSORTIUM OR JURIDICAL ENTITY

The documents submitted by TRANSCO, such as the single line diagram of the subject subtransmission assets, showed that DECORP is the only distribution utility connected thereto. Thus, a consortium or a juridical entity need not be formed.

D. ASSESSMENT OF DECORP'S QUALIFICATION AS BUYER OF THE SUB-TRANSMISSION ASSETS

1. TECHNICAL CAPABILITY

- a. DECORP has no experience in the operation and maintenance of similar subtransmission assets operating at the same voltage level. However, it submitted a "Statement of Commitment" to undergo at least a one (1) month training program to be conducted by TRANSCO.
- b. DECORP has no inventory of materials that can be used for immediate replacement during emergency repair and maintenance of the line. However, DECORP submitted a "Certificate of Availability of Inventory" stating that the materials necessary are ready and available upon the turn over of operation and maintenance of the subject assets.
- c. DECORP has submitted a certification and list of qualified personnel with experience in the operation and maintenance of subtransmission lines and substation facilities.
- d. Details of the power interruption documents submitted by DECORP disclosed that it has 0.196 Interruption Frequency Rate and 48.33 hours of Cumulative Interruption Time. This makes the Reliability Performance of DECORP to be 44.52% which complies with the allowable maximum limit of 80% set in the Guidelines.
- e. Records of the Commission revealed that DECORP has submitted its Statement of Compliance to the Philippine Grid Code (PGC) and Philippine Distribution Code (PDC) which makes it compliant with the qualification criteria that "a prospective buyer should have submitted to the ERC its Statement of Compliance to the Philippine Grid Code and Philippine Distribution Code".
- f. The Commission's evaluation of DECORP's Statement of Compliance and Compliance Plan to the PGC and PDC showed that it is in full compliance with DSC-PGC-019 (Maintenance

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Program) but not for DSC-PDC-038 (Maintenance Program). However, it has definite compliance plans and schedules to complete the requirements of the said standards. DECORP was found to be in compliance with three (3) other requirements of the PGC and four (4) other requirements of the PDC.

Thus, it can be said that DECORP is technically qualified to buy and operate the subtransmission assets of TRANSCO pursuant to Article IV, Section 1 of the Guidelines.

2. FINANCIAL CAPABILITY

A thorough examination of the Audited Financial Statements (AFS) of DECORP and other documents submitted disclosed that:

- a) It is current in all its financial obligations related to all contracts with suppliers of inputs necessary for its provision of electricity service to its end-users.
- b) It is current in all its financial obligations related to outstanding debt to all listed creditors.
- c) It is current in all its financial obligations with the National Power Corporation (NPC) on the payments of its monthly power bills.
- d) Its current ratio is 1.85:1 and its quick ratio is 1.76:1 (*ratios should not be less than 0.80:1 for current ratio and 0.70:1 for the quick ratio*), as shown by the computations below:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{528,593,700}{285,046,822} = 1.85:1$$

$$\text{Quick Ratio} = \frac{\text{Quick Assets Minus Inventory}}{\text{Total Current Liabilities}} = \frac{502,696,860}{285,046,822} = 1.76:1$$

Based on the foregoing, the computed Current and Quick Ratios of DECORP passed the criteria set in the Guidelines.

- e) DECORP has a debt ratio of 0.49:1 which is within the maximum limit of 0.70:1 set in the Guidelines, as shown by the computation below:



$$\text{Debt Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}} = \frac{663,645,972}{1,364,413,636} = 0.49:1$$

This means that DECORP complied with the Debt Ratio criterion.

- f) The average collection period of DECORP is forty-five (45) days or within the criterion set in the Guidelines which should not be more than sixty (60) days; as shown by the computation below:

$$\begin{aligned} \text{Average Collection Period} &= \frac{\text{Ave. Yr. Begin \& Yr. End Receivables}}{\text{Sales}/365} \\ &= \frac{195,405,540}{4,336,407} = 45 \text{ days} \end{aligned}$$

- g) DECORP's net profit margin and return on assets as computed disclosed positive values which mean that it passed the criteria set in the Guidelines, as shown by the computation below:

$$\text{Net Profit Margin} = \frac{\text{EBIT}^1}{\text{Sales}} = \frac{138,608,234}{1,582,788,645} \times 100\% = 8.76\%$$

$$\text{Return On Assets} = \frac{\text{EBIT}}{\text{Ave. Total Assets}} = \frac{138,608,234}{1,263,235,922} \times 100\% = 10.97\%$$

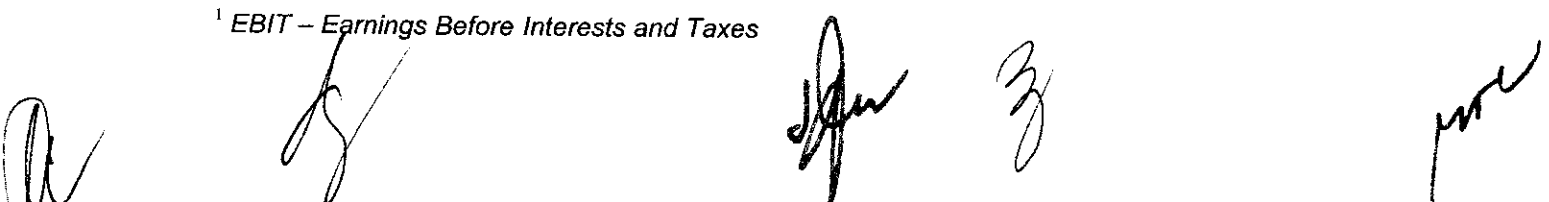
Based on the foregoing, it can be concluded that DECORP is financially qualified to buy the subtransmission assets pursuant to Section 2, Article IV of the Guidelines.

E. SUBTRANSMISSION ASSETS VALUATION

1. Selling Price of the Subtransmission Assets

The valuation agreed upon by TRANSCO and DECORP based on sound value is Twenty-Seven Million Three Hundred Forty Thousand Five Hundred Fifty-Six Pesos and Ten Centavos (Php27,340,556.10).

¹ EBIT – Earnings Before Interests and Taxes



The contract between TRANSCO and DECORP was entered into on November 15, 2005. Thus, the value of the subject assets to be paid by DECORP should be based on the agreed price instead of SKM valuation.

The following were the steps undertaken by TRANSCO in the Valuation Process:

- a) The value of subtransmission assets was established based on its reappraised sound values taking into account the cost of replacing the asset with a new one, or referred to as replacement cost, new (RCN), and the physical and operating condition of the assets. The formula used is as follows:

$$\text{Sound Value (SV)} = \text{RCN} \times \text{Condition Factor}^2$$

- b) The SV, as defined in Section 2, Article II of the Guidelines, shall refer to the market value of an asset taken or the current replacement costs of the assets less accumulated depreciation based on the actual condition of the asset.
- c) The value of the assets is inclusive of adjustments based on additional structures installed and replacements/improvements undertaken after the inspection.
- d) The condition of the assets are evaluated by TRANSCO's field personnel as determined from the actual inspection of the assets jointly conducted by TRANSCO and DECORP in the presence of the Commission on Audit (COA). The assignment of condition rating of the assets, which is in numerical form, is in accordance with the TRANSCO condition rating standards.

This methodology is being applied uniformly by TRANSCO in calculating the value of all subtransmission assets in all areas, including DECORP.

² Condition Factor used ranges from 0.30 to 1.0



2. Third Party Appraisal Report

The application was overtaken by the amendment of Article V, Section 4 of the Guidelines whereby concerned parties to the proposed sale and transfer of subtransmission assets of TRANSCO are required to submit appraisal report, including the appraiser's estimate on the remaining life of the subtransmission assets for disposal.

TRANSCO engaged the services of Sinclair Knight Merz (SKM) together with PricewaterhouseCoopers and CUERVO Appraisers Corporation to appraise its fixed assets. The Third Party Appraisal Report placed the Total Value of the Assets at PhP35,919,000.00 which is higher than the TRANSCO computation.

3. Revenue Potential

The Commission conducted the disposal value of the subtransmission assets based on the revenue potential of such assets.

The potential revenue is interpreted as the total benefit foregone by TRANSCO in selling the subtransmission assets to a qualified distribution utility (DU). Potential Revenue is entirely dependent on the approved value of the assets when setting the rates. The rates that are set determine the revenue streams.

It is worth mentioning that the appraised value of TRANSCO's assets was not determined by TRANSCO alone, but rather, it was determined by both parties in the presence of COA and since the Lease

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Purchase Agreement was entered into by both parties on November 15, 2005, it can be concluded that the agreed purchase price was the best estimate and representation of potential revenue then.

F. TERMS OF PAYMENT

Under the terms of the Contract to Sell, DECORP shall pay TRANSCO, in cash or in the form of manager's or cashier's check, the amount of **Twenty-Seven Million Three Hundred Forty Thousand Five Hundred Fifty-Six Pesos and Ten Centavos (PhP27,340,556.10)** which shall be made in ten (10) calendar days from receipt of the notice of the Commission's approval of the said Contract to Sell.

G. CONNECTION CHARGES

On December 7, 2007, the Commission issued a Decision in ERC Case No. 2007-007 RC entitled "*In the Matter of the Application for the Approval of Connection Charges and Residual Sub-transmission Charges for Calendar Year 2007 on the Excluded Services Covering the Existing Sub-transmission Assets of the National Transmission Corporation (TransCo) and any Future Concessionaire Thereof, with Prayer for Provisional Authority*". In the said Decision, DECORP's monthly connection charge and residual charge are PhP23,943.13 and PhP1,059,560.24, respectively.

TRANSCO shall immediately cease billing of the current connection charge upon the date of final sale of the subtransmission assets.



H. ANALYSIS

The valuation agreed upon by TRANSCO and DECORP is PhP27,340,556.10. Said valuation price was conducted jointly by the TRANSCO District Office, DECORP and COA and was based on a certain formula which considers a condition factor.

In order to avoid windfall gain on the part of DECORP, the approved selling price shall be the regulatory value of the subject subtransmission assets. Moreover, the subtransmission assets shall not be subject to any appraisal increase in the future unless the utility has invested for its upgrading or refurbishment to extend the life or improve the performance of the assets.

After a thorough evaluation of the documents and the testimonies of the witnesses presented herein, the Commission finds that:

- a) The subject lines for sale are subtransmission assets;
- b) The acquisition cost of the assets was already included in the approved Maximum Average Price (MAP) of DECORP;
- c) DECORP is qualified to take over the responsibility of operating, maintaining, upgrading and expanding said subtransmission assets; and
- d) The purchase price of the subject subtransmission assets is fair and reasonable.

WHEREFORE, the foregoing premises considered, the application for the approval of the sale of various subtransmission lines/assets within the franchise area of Dagupan Electric Corporation (DECORP) filed by the National Transmission Corporation (TRANSCO) is hereby **APPROVED**.

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Upon the consummation of the sale, let a copy of the corresponding Deed of Absolute Sale between TRANSCO and DECORP be furnished the Commission, for record purposes.

SO ORDERED.

Pasig City, October 20, 2008.


ZENAIDA G. CRUZ-DUCUT
Chairperson


RAUF A. TAN
Commissioner


ALEJANDRO Z. BARIN
Commissioner


MARIA TERESA A.R. CASTAÑEDA
Commissioner


JOSE C. REYES
Commissioner

Copy furnished:

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Atty. Leon T. Tapel, Jr.
Atty. Marlon V. Destura
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2. **THE OFFICE OF THE SOLICITOR GENERAL**
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Metro Manila
3. **THE COMMISSION ON AUDIT**
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Diliman, Quezon City, Metro Manila
4. **THE COMMITTEE ON ENERGY**
House of the Senate
GSIS Building, Roxas Boulevard, Pasay City, Metro Manila
5. **THE COMMITTEE ON ENERGY**
House of Representatives
Batasan Hills, Quezon City, Metro Manila
6. **DAGUPAN ELECTRIC CORPORATION (DECORP)**
Dagupan City, Pangasinan
7. **The City Mayor**
Dagupan City
8. **The Municipal Mayor**
San Fabian, Pangasinan
9. **The Municipal Mayor**
Calasiao, Pangasinan
10. **The Municipal Mayor**
Sta. Barbara, Pangasinan
11. **The Municipal Mayor**
San Jacinto, Pangasinan
12. **The Municipal Mayor and Heads of Barangay**
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