

benchmark levels for each of these building blocks. These benchmark levels can likewise be used to classify the ECs into several groupings.

The Commission is in the process of developing the model that it will use to establish benchmark rates for each rate component of the revenue requirement. The Commission understands that the NEA, in its partnership with the UPNEC and other consulting firms, is also in the process of setting efficiency benchmarks. It has identified several approaches to setting such benchmarks, which include the following:²⁹

- Historical costs
- Engineering modelling
- Comparative efficiency measurement

The Commission will appreciate receiving a copy of the results of the efficiency benchmarking prepared by NEA and its consultants and the paper prepared by Rouselle F. Lavado, entitled Benchmarking the Efficiency of Philippine Electric Cooperatives Using Stochastic Frontier Analysis and Data Envelopment Analysis.³⁰

In developing the benchmark levels, The Commission will consider the following operational and financial parameters, which may be expanded as the model is completed:

- Customer/Circuit kilometer
- kWh sales/Circuit kilometer
- kWh sales/Customer
- Distribution Cost/Customer
- Distribution Cost/Circuit kilometer
- Distribution Cost/kWh sales
- Administrative & General Cost/Customer
- Information Cost/Customer
- Administrative & General Cost/kWh sales
- Information Cost/kWh sales
- Customer/Employee
- Value of Total Plant in Service/Customer
- Value of Total Plant in Service/kW peak demand
- System Loss
- Debt Service Coverage Ratio

The Commission intends to work and collaborate closely with the ECs in the development of the parameters. The Commission will issue another follow-on paper to discuss the model in the near future.

7.1 Classification of Electric Cooperatives

The Commission intends to stratify the cooperatives into several groups using a set of criteria that include but may not be limited to the following:

- a) Size
- b) Load mix
- c) System loss
- d) Financial performance
 - i) Debt service coverage ratio
 - ii) Net profit margin
 - iii) Return on assets
- e) Reliability
 - i) System average interruption frequency index
 - ii) System average interruption duration index
 - iii) Momentary average interruption frequency index
- f) Efficiency Ratio (average collection period)
- g) System efficiency
- h) Customer service
 - i) Service interruption
 - ii) Informed schedule of power interruptions
 - iii) Response time
 - iv) Reconnection service
- i) Compliance to regulatory issuances

UPNEC/NEA recommended the possible inclusion of environmental performance as one of the performance indicators under a PBR.³¹ While this may be laudable, it may not really be applicable to a distribution utility since the Clean Air Act or RA 8749 prescribes environmental standards for stationary sources only such as steam generators or geothermal power plants, oil-fired and coal-fired power plants.³² The environmental standards may only be applicable for electric cooperatives that own or operate the aforementioned types of generating units.

The Commission plans to work closely with NEA and the electric cooperatives in the finalization of the classification criteria. The Commission intends to issue a brief and separate module on this.

7.2. Uniform Tariffs for Each Expense Account

The results of the benchmarking model are expected to provide the Commission a range of levels for each identified building block of the revenue requirement. The Commission may opt to approve uniform tariffs for each expense account for all ECs falling within a classification. For example:

Benchmark Levels for Each Rate Component, PhP/kWh (Classification A)

Rate Component	Low	High
Payroll	0.0345	0.0460
Operation & Maintenance	0.0268	0.0315
Administrative & General	0.0189	0.0199

Benchmark Levels for Each Rate Component, PhP/Customer/month (Classification A)

Rate Component	Low	High
Payroll	20.00	23.00
Operation & Maintenance	48.00	51.00
Administrative & General	27.00	30.00

Benchmark Levels for Each Rate Component, PhP/kWh (Classification B)

Rate Component	Low	High
Payroll	0.0389	0.0497
Operation & Maintenance	0.0305	0.0378
Administrative & General	0.0198	0.0213

Benchmark Levels for Each Rate Component, PhP/Customer/Month (Classification B)

Rate Component	Low	High
Payroll	24.00	26.00
Operation & Maintenance	52.00	53.00
Administrative & General	31.00	33.00

The Commission may use either the lower range numbers or the higher end numbers as the uniform tariffs to be applied for all ECs falling within a classification. As such, the rates for all the ECs in Classification A would be uniform for each account. In the same manner, the rates for all the ECs in Classification B would have the same rate levels for each account.

Regardless of the tariff setting methodology chosen, the Commission is inclined to segregate expense accounts that should not fall within the caps. These would include depreciation, if applicable, debt service and/or reinvestment fund. These would have to be utility specific since these are largely dictated by the capital expansion plan approved by the Commission.

7.3 Uniform Caps for Each EC Classification

On the other hand, the Commission may use the resulting benchmark higher end levels as the cap. The cap, ideally however, should be on a total utility basis and should probably not include depreciation expense, if applicable, debt service components and/or the CAPEX fund. The benchmark rates serve as a trigger mechanism that would signal the EC to file a petition before the ERC for a new rate case. Similar to the previous case, the caps may be expressed either as a cost per kWh and/or a fixed amount per customer per month.

Benchmark Levels for Each Rate Component, PhP/kWh (Classification A)

Rate Component	Low	High
Payroll	0.0345	0.0460
Operation & Maintenance	0.0268	0.0315
Administrative & General	0.0189	0.0199
Total	0.0802	0.0974

Using Classification A as an example, the total rate of the utility may reach as high as PhP 0.0974 per kWh. If the rate breaches this cap, this acts as the trigger mechanism

that will require a new rate case filing for the EC. The EC, on the other hand, may choose just to stay within the cap despite an increase in its cost to avoid all the procedural requirements and a possibly protracted public hearing.

7.4 Caps for Each Expense Account

On a more restricted viewpoint, the Commission may set individual caps for each expense account. As such, using the numbers for Classification A, all ECs within this group should not bill payroll for more than PhP 0.0460 per kWh. This is probably a more rigid and more difficult policy to implement.

7. New Rate Case Filings

The Commission is inclined to mandate new rate case filings for all the ECs. The new rate case will allow the ECs to reflect the most recent operational performance since the existing unbundled rates were based on costs and performance obtained six years ago. The new petitions will likewise embody new loans incurred by the ECs. In the new rate case filings, the Commission plans to mandate that the cases incorporate the following principles:

8.1 Wire Business Component by Voltage Level

The investments for the wire business segment should be allocated on a voltage level. This would allow for proper assignment of costs among users of the network based on the voltage it is being served. As previously discussed, customers connected at the 34.5 kV should not be paying for investments and costs attributable to lower voltages.

7.2. System Loss by Voltage Level

The new rate filings should also determine system losses by voltage. This should be feasible once the EC complies with the Guidelines for the Application and Approval of Caps on the Recoverable Rate of Distribution System Losses. In the same vein as the previous discussion, customers connected at the 34.5 kV should not pay for losses below that voltage. This means that customers connected at the lowest voltage of 220 v should pay for all the line losses proportionately allocated among the users of the network.

The Commission has granted the request of the distribution utilities to extend compliance to the above-mentioned Guidelines to 31 October 2006.³³ Upon the

request of the distribution utilities, this deadline was further extended to 31 January 2007.

7.3. New Customer Segments

The Commission also intends to redefine the ECs' customer classes. The Commission is inclined to classify the customers based on the power service delivery voltage. This allows for a fair and justifiable allocation of costs and is fully in line with cost of service principles.

All new rate cases would have to be filed in conformity with the provisions of A Resolution Promulgating the ERC's Rules of Practice and Procedures.³⁴ This document discusses in detail all procedural requirements including supporting documents and information specifically for applications for a general change in rate schedules or revision of rates.

8. Other Concerns of the Electric Cooperatives

The Commission takes this opportunity to address other issues and respond to proposed modifications in setting the tariffs for the ECs as contained in the paper entitled Electric Cooperative Rate Relief Proposal dated 15 May 2006.

9.1. Other Issues Raised

9.1 Test-year adjustments for "known and measurable" changes³⁵

Cognizant of the need by the distribution utilities to recoup incremental costs arising from factors that are not within the utility's control, the Commission has approved, beginning 2003, a pass-thru mechanism that allowed for recovery or refund due to changes in generation costs. The Commission first promulgated the Guidelines governing the Generation Rate Adjustment Mechanism (GRAM), which allowed ECs that procure 100% of its power supply requirements from the National Power Corporation (NPC) to change its generation rates simultaneously with the change in NPC's rates.

The GRAM has since been replaced by an automatic mechanism in October 2004, the Automatic Generation Rate Adjustment (AGRA), which allows automatic changes not only in the generation rates but also the system loss rates. The Commission has also promulgated guidelines that enabled the distribution utilities to bill the end-users any incremental costs due to changes in the transmission rates, inter-class cross subsidy rates and lifeline rates.

In light of the most recent ruling of the Supreme Court, the Commission may have to revisit the implementation of all automatic adjustment clauses.³⁶ In its

Resolution dated 16 August 2006, the Supreme Court ruled that, “xxx unless Section 4(e), Rule 3 of the IRR of the EPIRA is amended, the adjustments of rates based on purchased power or fuel adjustment costs shall not or in no case be automatic”.³⁷

While the Commission realizes that the utility is unable to make periodic changes in distribution rates without a rate case filing, the Commission believes that the growth in load may partially cover increasing costs due to passage of time. One of the options being explored by the Commission in designing a new regulatory framework is the application of an inflation-based index on the rates as discussed in Section IV of this document.

9.2 Provision for cash working capital³⁸

The ECs request that a cash working capital provision be integrated into the rates. The Commission believes that a careful lead lag study needs to be undertaken to establish if there is indeed such a need. Moreover, if the EC borrows funds to bridge finance expenses incurred for operations, such borrowing costs are reflected as part of the debt service and as such, are incorporated into the EC's rates.

The inclusion of a cash working capital in the calculation of the rates would be contingent on the rate setting methodology adopted by the Commission in the future. Any cash working capital provision under a rate of return regime is reflected as part of the rate base.

9.3 Tax Recovery³⁹

The Commission takes exception to the statement that “...the ERC cannot absolve itself of responsibility” with respect to the non-inclusion of tax recovery components in the unbundled rate Orders. The Commission allowed the recovery of real property taxes in cases when the petition includes such taxes. Real estate taxes, moreover, requires a detailed evaluation of the utility's ownership of such assets before the Commission allows the inclusion of these types of taxes in the electricity rates.

It should be underscored that nothing precludes the ECs from filing an updated and new rate case petition to reflect recent changes in costs if the ECs are truly under recovering.

The Commission stands by its policy that the distribution utilities should bear the cost of any management inaction and/or management risks. As such, penalties, consequent to a management decision to incur arrears should not be passed on to the end-users.

9.4 Full recovery of system losses⁴⁰

The ECs contend that the Commission allow full amount of system losses with simultaneous authorization of funding to implement a loss reduction plan. The Commission recognizes that the existing uniform system loss caps may not be appropriate for all the ECs given the differences in the load density, the level of the franchise area's urbanization and the utility's load mix. The Commission, as early as 2004, has provided the ECs with the mechanism to support and file a system loss cap that would tailor fit the specific EC with the promulgation of the Guidelines for the Application and Approval of Caps on the Recoverable Rate of Distribution System Losses. This gave the EC the opportunity to be accorded a system loss cap that may be higher than 14% should the EC be able to prove that the present system loss cap is not technically feasible.

The Orders on the unbundled rate cases for the ECs mandated the submission within a year from the date of the order a system loss reduction program that would be funded through the reinvestment fund. Further, the Commission is already in the process of approving the Capital Expansion Plans, which ideally should incorporate both the plan to improve the system loss and the corresponding funding for the reduction plan. To date, the Commission has already approved a total of three (3) CAPEX plans, all of which are for the ECs.

9.5 Full recovery of power supply contracts approved by former regulators or NEA⁴¹

The ECs allege that the ERC disallowed portions of generation costs supported by contracts that have been approved by former regulators or NEA. In the resolution of the unbundled rate cases, the Commission has adopted the policy of respecting the terms and conditions of power supply contracts that have had prior approval from either the then Energy Regulatory Board (ERB) or the NEA.

In the evaluation of the generation costs components, the ECs have the burden of proof to demonstrate prior approval of power supply contracts. The Commission notes that a number of ECs have failed to submit or show documents that support claims of ERB or NEA approval. This would include power supply arrangements with nearby electric cooperatives. The Commission retains its prerogative to disallow portions of generation costs, which the Commission believes are disadvantageous to the electricity consumers the EC services.

The paper charges the Commission with disallowance of portions of the generation costs for Pampanga Electric Cooperative II (PELCO II) and Isabela Electric Cooperative I (ISELCO I). The Commission revisited the Decisions for

the two (2) cited unbundled rate cases to determine the reasons for disallowance of the generation costs, if any.

The Commission noted that at the time of the Decision, (18 February 2004), PELCO II was buying one hundred percent (100%) of its power supply requirements from NPC since its power supply contract with Angeles Power Inc. expired in December of 2003. As such, the Commission allowed PELCO II to fully recover its generation costs.⁴²

The Commission also reviewed its Decision on the unbundled rate case of ISELCO I. The Commission noted that ISELCO I sources its electric power from four (4) utilities, two of which are from the nearby electric cooperatives: Quirino Electric Cooperative (QUIRELCO) and Isabela Electric Cooperative II (ISELCO II). Unfortunately, ISELCO I failed to provide supporting documents to prove that its power supply arrangements with its nearby cooperatives have been duly approved by either then ERB or NEA. The Commission maintains that generation should only be a passed-thru costs and no distribution utility should earn additional income for this component. The Commission further maintains that the nearby ECs which provide generation to ISELCO I should have billed ISELCO I only for distribution wheeling charges, the actual generation cost, the proportionate transmission charges and the corresponding system losses.⁴³

9.6 Supplier required security deposits⁴⁴

The ECs contend that the required security deposits by TRANSCO were not included in the unbundled rate cases; nor were such requirement anticipated. The Commission believes that security deposits are similar in nature to cash working capital; as such, it would only have an impact on the revenue requirement if the EC has actually borrowed funds to make the deposits. In such cases, the loans associated with this deposit are reflected as part of debt service and are then included in the revenue requirement. The Commission would like to underscore that nothing precludes the ECs from filing a new rate case to cover this under recovery.

9.7 Transition to retail open access⁴⁵

The ECs argue that the Commission erred in the functional allocation of costs i.e. *“xxx costs which are in fact fixed have been wrongly allocated to the generation function.”* The paper, unfortunately, failed to specify or identify the alleged fixed costs that were wrongly allocated. If such were the case, the ECs could have filed a Motion for Reconsideration and could have clearly pointed out the oversight. The Commission has demonstrated enough flexibility to correct itself when so required.

The Commission emphasizes that the unbundling of the rates was not a whimsical act as seemingly stated in the paper (*The ERC added a new layer of rate structure*

by establishing unbundled costs xxx)⁴⁶ but was in compliance with the mandate espoused under Section 36 of the Act.

9.8 Expedited Tariff Approval Procedure (ETAP)⁴⁷

The ECs propose to cut down the regulatory lag by proposing an Expedited Tariff Approval Procedure (ETAP), which calls for automatic approval of the petition without hearing and the approval made effective thirty (30) days from the filing date. While the Commission appreciates the need for an expedited process in the resolution of rate cases, the Commission is constrained by the provision of Section 4(e) Rule 3 of the IRR.

9.9 Provisional rate relief⁴⁸

The ECs propose a time limit of ninety (90) days on regulatory action from the rate application to final order with automatic provisional rate approval in cases where the time limit is not met. The Commission is not averse to granting provisional rates when requested for and when warranted. The Commission, however, believes that the imposition of 90 days on regulatory action may not be feasible given the 140 power utilities it regulates.

The Commission will likewise grant provisional authority in consonance with its Rules of Practice and Procedure, which mandates a minimum waiting time of thirty (30) days from the receipt of a copy of the application or petition by the LGU legislative body concerned or publication of the application or petition in a newspaper of general circulation, whichever comes later.⁴⁹ The Commission has twelve (12) months from the issuance of a provisional authority to resolve the case.

9.10 Non-Rate Orders⁵⁰

The ECs allege that the quantity of non-rate orders issued by the Commission imposes administrative requirements and resource burdens on the ECs. The paper further stated that such actions constitute a trend towards "*regulatory encroachment into EC board policy and management*". The ECs cited the Commission's requirements for director training, consumer welfare desk, regulatory compliance officer, among others.

Section 41 of the Act mandates ERC to handle consumer complaints and ensure the adequate promotion of consumer interests. In line with this mandate, the Commission implemented orderly procedures for customer complaints to be attended to at the soonest time possible. Given the lack of ERC regional offices nationwide, the establishment of consumer welfare desks in each distribution utility was an effective mechanism used not only in ensuring that the interest of the public is protected but likewise allows the Commission to monitor the utility's response to consumer complaints.

Other non-rate administrative Orders are geared towards upgrading the technical competence of the utility's management and establishment of procedures for easy and continuous monitoring of the utility's compliance to the Commission's issuances.

9.2. Future Steps

9.2.1. Joint actions between or among the distribution utilities

Section 23 of the Act encourages distribution utilities to pursue structural and operational reforms to achieve economies of scale in utility operations. These reforms may include joint actions between or among the distribution utilities that would result in improved efficiencies, reliability of service, reduction of costs and compliance to the performance standards prescribed in the IRR of the Act. Joint actions may include joint or bulk procurement policies, aggregation of loads and other similar activities. The Commission shall issue the required rules governing the joint actions of the distribution utilities within next year.

9.2.2 Mergers, acquisitions

Section 7 Rule 7 of the IRR provides for implementation of reforms that may include mergers, consolidation and integration for greater efficiency and costs. The Commission recently promulgated the Competition Rules, which govern mergers and consolidation of distribution utilities.⁵¹

9.3. Role of NEA under the Act

The ECs have incessantly raised the lack of funding sources after the passage of the Act. The ECs claim that NEA can no longer lend money to the ECs, forcing the ECs to seek borrowings from commercial avenues. Section 58 of the Act and Section 3 (a) (ii) (1) Rule 3 of the IRR clearly did not limit the lending function of the NEA. The Commission seeks to clarify the role NEA currently plays for the ECs under the restructured electric power industry environment.

9.4. Redefining the lifeline rate policy

The Commission may also take this opportunity to revisit its current lifeline rate policy. The issues on the lifeline rate may include the following:

9.4.1 Uniform consumption threshold for urban and rural marginalized end-users;

- 9.4.2 Fixed discounts instead of a graduated percentage discounts;
- 9.4.3 Lower consumption threshold for some utilities but different consumption threshold for urban and rural marginalized households

End Notes

- ¹ Resolution 37 series of 2006 dated 18 July 2006
- ² PD 269 creating the National Electrification Administration was signed on 06 August 1973
- ³ Franchising powers delegated to NEA
- ⁴ EPIRA did not limit the lending power of NEA; Section 3 (a) (ii) (1) clearly provides that NEA may offer services to the ECs other than those related to its lending function xxx.
- ⁵ ERC Decision on ERC Case No. 2004-449: Approval of a Subsidized/Approved (formerly termed Socially Accepted) Generation Rates and Corresponding Universal Charge Missionary Electrification Subsidy for Fourteen (14) First Wave NPC-SPUG areas, 16 December 2005.
- ⁶ Computed as 5% of the EC's total revenue requirement.
- ⁷ Excluding income tax
- ⁸ Pursuant to ERC Guidelines on Tax Recovery Adjustment Mechanism for Electric Cooperatives promulgated on 11 January 2006
- ⁹ Allows for automatic recovery of incremental costs or changes due to movements in generation rates
- ¹⁰ Castalia Strategic Advisors: Philippines Rural Electrification Regulatory Framework Project: Phase II Policy Report, November 2003, page 11
- ¹¹ UP NEC, NEA, et al, Strengthening the Institutional Capacity in the Philippines to Prepare the Electric Cooperatives for the Adaptation of Performance-Based Regulation, September 2006, Consultation Paper No. 1, Proposed PBR Framework for Electric Cooperatives, page 9
- ¹² Data Source: 2002 Audited Financial Statements
- ¹³ Regulatory Reset for the Privately Owned Distribution Utilities Subject to Performance Based Regulation: Issues Paper, 30 September 2005, page 49
- ¹⁴ NRECA International, Ltd et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 8
- ¹⁵ Based on ERC Decisions on rate case unbundling; amount includes interest expense
- ¹⁶ Data Source: Audited financial statements
- ¹⁷ Castalia Strategic Advisors: Philippines Rural Electrification Regulatory Framework Project: Phase II Policy Report, November 2003, page 11
- ¹⁸ NRECA International, Ltd et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, pages 6-7
- ¹⁹ Based on ERC Orders on rate case unbundling
- ²⁰ Resolution No. 13 series of 2006 dated 8 March 2006
- ²¹ UP NEC, NEA, et al, Strengthening the Institutional Capacity in the Philippines to Prepare the Electric Cooperatives for the Adaptation of Performance-Based Regulation, September 2006, Consultation Paper No. 1, Proposed PBR Framework for Electric Cooperatives, page 9
- ²² Ibid, page 5
- ²³ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 9
- ²⁴ UP NEC, NEA, et al, Strengthening the Institutional Capacity in the Philippines to Prepare the Electric Cooperatives for the Adaptation of Performance-Based Regulation, September 2006, Consultation Paper No. 1, Proposed PBR Framework for Electric Cooperatives, page 11
- ²⁵ Ibid, page 12
- ²⁶ In the resolution of the unbundled rate cases, the Commission adopted the policy that the lifeline rate shall not be lower than 5 centavos per kWh but not higher than 10 centavos per kWh.
- ²⁷ <http://management.about.com>

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- ²⁸ www.benchmarking.gov.uk
- ²⁹ UP NEC, NEA, et al, Strengthening the Institutional Capacity in the Philippines to Prepare the Electric Cooperatives for the Adaptation of Performance-Based Regulation, September 2006, Consultation Paper No. 2, Incentive Structure for EC PBR, pages 5-10
- ³⁰ UP NEC, NEA, et al, Strengthening the Institutional Capacity in the Philippines to Prepare the Electric Cooperatives for the Adaptation of Performance-Based Regulation, September 2006, Consultation Paper No. 1, Proposed PBR Framework for Electric Cooperatives, page 12
- ³¹ *Ibid*, page 13
- ³² Section 19, Article III, Clean Air Act, 23 June 1999
- ³³ Order dated 20 April 2006
- ³⁴ Resolution No. 38 Series of 2006, 22 June 2006
- ³⁵ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 9
- ³⁶ G. R. No. 163935: National Association of Electricity Consumers for Reforms (NASECORE), et al vs. ERC and MERALCO, Resolution dated 16 August 2006
- ³⁷ Supreme Court Resolution, 16 August 2006, page 15
- ³⁸ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 12
- ³⁹ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 12
- ⁴⁰ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 10
- ⁴¹ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 11
- ⁴² ERC Case No. 2202-030/2001-912, Decision dated 18 February 2004
- ⁴³ ERC Case No. 2001-943, Decision dated 22 December 2003
- ⁴⁴ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 13
- ⁴⁵ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 5
- ⁴⁶ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 1
- ⁴⁷ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 3
- ⁴⁸ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 4
- ⁴⁹ ERC's Rules of Practice and Procedure, 22 June 2006, Section 3 of Rule 14, page 19
- ⁵⁰ NRECA et al, Electric Cooperative Rate Relief Proposal, 15 May 2006, page 3
- ⁵¹ ERC Competition Rules and Complaint Procedures dated 23 August 2006