

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

IN THE MATTER OF THE APPLICATION
FOR APPROVAL OF THE UNBUNDLED
RATES PURSUANT TO THE PROVISIONS
OF REPUBLIC ACT NO. 9136

ERC CASE NO. 2001-979

ORIENTAL MINDORO ELECTRIC COOPERATIVE,
INC. (ORMECO),

Applicant.

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DECISION

Before this Commission for resolution is the application filed on December 26, 2001 by applicant Oriental Mindoro Electric Cooperative, Inc. (ORMECO) for approval of its unbundled rates pursuant to the provision of Republic Act No. 9136. Subsequently, on January 16, 2002 and February 12, 2002, ORMECO filed "Supplemental Compliance" and additional data, respectively, in compliance with the unbundling requirements. On March 25, 2002, ORMECO filed an "Additional Compliance" indicating therein the specific rates applied for.

Having found said application sufficient in form and substance with the required fees having been paid, an Order and a Notice of Public Hearing, both dated April 9, 2002 were issued setting the case for initial hearing on May 28, 2002.

ORMECO was directed to cause the publication of the Notice of Public Hearing, at its own expense, twice (2x) for two (2) successive weeks in two (2) newspapers of general circulation in the country, the last date of publication to be made not later than two (2) weeks before the scheduled date of initial hearing. In compliance with the said directive, ORMECO published the Notice of Public Hearing in *Malaya* and *Balita* on May 4 and 11, 2002 and May 5 and 12, 2002, respectively.

The Office of the Solicitor General (OSG), the Commission on Audit (COA) and the Committees on Energy of both Houses of Congress were furnished 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 Mayors of the City of Calapan and the Municipalities of Baco, Naujan, Puerto Galera, San Teodoro, Victoria, Bansud, Bongabong, Gloria, Mansalay, Pinamalayan, Pola, Roxas, Socorro and Bulalacao, all in the Province of Oriental Mindoro, were furnished copies of the Order and the

Notice of Public Hearing for the appropriate posting thereof on their respective bulletin boards.

On May 22, 2002, the Commission received a letter from Mayor Jesus Dimapilis of the Municipality of Roxas, Oriental Mindoro, requesting for the conduct of the public hearing in Mindoro. The Commission denied said request in its letter dated May 23, 2002.

During the initial hearing on May 28, 2002, Atty. Zenon S. Suarez appeared as counsel for ORMECO while the Honorable Representatives Charity Leviste and Alfonso Umali appeared as intervenors.

At the said hearing, ORMECO was able to submit only five (5) Certificates of Posting of the Order and the Notice of Public Hearing which were duly marked as Exhibits "A" to "C-4", inclusive. ORMECO manifested that the other Certificates of Posting were inadvertently left at the office but assured the Commission that the same would be submitted at the most opportune time.

As there was no objection from the intervenors, the Commission provisionally allowed ORMECO to present its evidence subject to its submission of the other Certificates of Postings. Thus, ORMECO presented two (2) witnesses. The first witness, Mr. Romeo M. Cuasay, ORMECO's Finance Manager, identified and testified on the documents submitted in support of the application. In the course thereof, additional documents were

presented, identified by reference and marked as Exhibits “D” to “O”, inclusive. The second witness, Mr. Francisco L. Mercene, ORMECO’s Technical Services Manager, testified on the technical aspects of the application, particularly on the system loss reduction program. Both witnesses were asked clarificatory questions by the Commission and the intervenors.

Thereafter, the Commission directed ORMECO, in open court, to submit a more complete schedule for the removal of cross subsidies indicating therein, in terms of per kilowatt-hours, the subsidy provided by the industrial and commercial customers to the residential and streetlight customers per year. ORMECO then manifested that it would submit its formal offer of evidence after it has submitted the required documents.

On May 30, 2002, the Commission received the “Manifestation and Compliance” of ORMECO submitting therewith the other Certificates of Posting.

On June 11, 2002, the Commission received a letter dated May 27, 2002 from the Provincial Governor of Oriental Mindoro requesting that the hearing scheduled on May 28, 2002 be reset to another date and be held in his province. Said request was denied for being moot and academic, the same having been received only on June 11, 2002.

On June 14, 2002, ORMECO submitted the following documents:
(a) Computation of the three (3) year gradual removal of Inter-class Subsidy;

(b) Breakdown of Historical Test Year 2000 Salaries and Wages per Plantilla/Department; and (c) Breakdown of Other Charges for Historical Test Year 2000, Other Charges.

On July 12, 2002, ORMECO filed its "Formal Offer of Evidence". Relative thereto, in its letter dated August 16, 2002, the Commission directed ORMECO to submit additional data and documents.

On September 27, 2002 and November 18, 2002, ORMECO submitted the aforesaid additional data.

On April 11, 2003, ORMECO filed an "Amended Formal Offer of Evidence".

On April 14, 2003, ORMECO filed another "Amended Formal Offer of Evidence" to correct the "Amended Formal Offer of Evidence" submitted on April 11, 2003. The evidence submitted herein was admitted together with the purposes for which they were being offered.

I. SUMMARY OF ORMECO's APPLICATION

I.A. REVENUE REQUIREMENT

ORMECO's revenue requirement per unbundled application based on historical test year 2000 was as follows:

| ACCOUNT NAME | TEST YEAR | |
|---|------------|--------------------|
| kWh Sales | | 65,135,738 |
| Purchased Power | PhP | 183,642,290 |
| Payroll | | 37,926,275 |
| Operation and Maintenance (less Purchased Power & Payroll) | | 25,469,345 |
| Debt Service | | 12,246,513 |
| Revenue Requirement | PhP | 259,284,423 |
| Reinvestment Fund (5%) ¹ | | 12,536,859 |
| TOTAL REVENUE REQUIREMENT | PhP | 271,821,282 |

ORMECO's proposed revenue requirement was PhP 271,821,282 based on historical costs for the year 2000. The Overall Average Tariff Adjustment (OATA) published was PhP 0.1167/kWh. The same OATA was stated by witness Quasay, in his testimony on May 28, 2002 (Transcript of Stenographic Notes (TSN), May 28, 2002, page 23).

ORMECO also submitted Audited Financial Statements for the year 2000.

¹ In the UFR, this item is reflected as Plus Percentage for Cooperative Investment.

I.B. RATE STRUCTURE/DESIGN

The unbundled rates proposed by ORMECO are as follows:

Residential

| | | |
|------------------------|-----|----------------------|
| Retail Customer Charge | PhP | 17.02/customer/month |
| Metering Charge | | 12.98/customer/month |
| Energy Charge | | 3.9978/kWh |

Small Commercial

| | | |
|------------------------|--|----------------------|
| Retail Customer Charge | | 15.70/customer/month |
| Metering Charge | | 14.30/customer/month |
| Energy Charge | | 3.6896/kWh |

Large Commercial

| | | |
|------------------------|--|----------------------|
| Retail Customer Charge | | 12.82/customer/month |
| Metering Charge | | 37.18/customer/month |
| Energy Charge | | 3.1240/kWh |
| Demand Charge | | 50.59/kW NCP |

Industrial

| | | |
|------------------------|--|----------------------|
| Retail Customer Charge | | 16.88/customer/month |
| Metering Charge | | 83.12/customer/month |
| Energy Charge | | 3.1110/kWh |
| Demand Charge | | 49.98/kW NCP |

Public Buildings

| | | |
|------------------------|--|----------------------|
| Retail Customer Charge | | 15.31/customer/month |
| Metering Charge | | 14.69/customer/month |
| Energy Charge | | 3.4766/kWh |

Street Lights

| | | |
|--------------------------------|-----|----------------------|
| Distribution Facilities Charge | PhP | 20.00/customer/month |
| Generation Charge | | 4.5407/kWh |

I.B.1. FUNCTIONALIZATION, CLASSIFICATION and ALLOCATION

All of the functionalization and the allocation factors used by ORMECO were default factors provided in the Uniform Filing Requirements (UFR) prescribed by the Commission. These were adopted by ORMECO as applicable to its operations.

However, for certain distribution costs, ORMECO developed its own classification factors for its demand and customer-related costs using the Minimum Plant Method.

I.B.2. SYSTEM LOSS

Witness Cuasay, in his testimony stated that the system loss for the year 2000 was 13% (May 28, 2002, TSN, pages 28-29).

Witness Mercene stated that the system loss rate used is 13% (May 28, 2002, TSN, page 65). He further added that he assumed that out of the 13% system loss, 12% is technical loss while the remaining 1% is non-technical loss pertaining to right of way, kilowatt-hour not operating, wrong reading of meters and pilferage (May 28, 2002, TSN, pages 65-66, 73-74). Furthermore, Witness Mercene testified that the usual kinds of pilferage are the use of jumpers (May 28, 2002, TSN, pages 73-74).

The system loss reflected in ORMECO's unbundling application, particularly Schedule J: System Loss, was 12.59%.

I.B.3. INTER-CLASS CROSS SUBSIDY

ORMECO provided the amounts of cross subsidies for each customer type, as well as a program for the removal thereof.

| CUSTOMER TYPE | ADJUSTED EXISTING (PhP) | PROPOSED EXISTING (PhP) | INTER-CLASS CROSS SUBSIDIES (PhP) |
|----------------------|--------------------------------|--------------------------------|--|
| Residential | 175,531,902.15 | 186,423,011.51 | 10,891,109.36 |
| Small Commercial | 51,849,936.44 | 47,291,975.12 | (4,557,961.32) |
| Small Commercial | 10,320,439.81 | 8,483,807.52 | (1,836,632.29) |
| Industrial | 13,225,994.47 | 10,533,436.42 | (2,692,558.05) |
| Public Buildings | 17,755,623.31 | 15,278,954.35 | (2,476,668.97) |
| Street Lights | 3,137,385.82 | 3,810,097.08 | 672,711.26 |
| Total | 271,821,282.00 | 271,821,282.00 | 0.00 |

I.B.4. LIFELINE RATE and LEVEL

ORMECO proposed the following level and rate for marginalized end-users:

| | Option 1 (At Existing Rates) | Option 2 (At Proposed Customer Charges) | Option 3 (At Proposed Rate) |
|--------------|---|--|---|
| Level | 10 kWh | 10 kWh | 10 kWh |
| Rate | PhP 4.0402/kWh | PhP 30.00/ customer/month | Consumption at 10 kWh and below (for Mangyans only) are fully subsidized. |

During the hearing of the subject case, witness Cuasay stated that ORMECO's proposed lifeline level is 0 to 10 kilowatthours which is PhP 4.03 or equivalent to P40.402 per customer per month (May 28, 2002, TSN, pages 25-26).

I.C. OTHER CHARGES

ORMECO, in its subsequent submission, provided this Commission with information on its existing Other Charges as shown below. ORMECO did not propose any adjustment to these charges.

| PARTICULARS | RATES |
|---|---|
| A. Inspection Fee 1. Residential/Public Connections: Class A (1-5 outlets) Class B (6-10 outlets) Class C (11-20 outlets) Class D (above 20 outlets or 4 kW load and above) 2. Recreation Connection 3. Commercial Connection Class A (Small Commercial with 1-10 outlets) Class B (Large Commercial with 11 outlets and above or 4 kW load and above) 4. Industrial connection | PhP 20.00 40.00 60.00 100.00 60.00 70.00 100.00 200.00 |
| B. Connection Fee 1. Residential, Recreational, Public and Commercial Connections 2. Industrial Connections | 50.00 100.00 |
| C. Relocation of Meter | 50.00 |
| D. Request for Meter Testing/Calibration | 60.00 |
| E. Transformer Installation 1. 5, 10, 15 and 25 KVA 2. 37.5, 50 and 75 KVA 3. 100 KVA and above | 300.00 400.00 500.00 |
| F. Membership Fee | 5.00 |
| G. Transformer Rental 1. 10 KVA 2. 15 KVA 3. 25 KVA 4. 37.5 KVA | 582.00/year 639.00/year 810.00/year 1,055.00/year |
| H. Pole Rental 1. Over 20 lbs. of cable per foot 2. Less than 20 lbs. of cable per foot | 15.00/pole/month 9.00/pole/month |
| I. Reconnection Fee | 100.00 |
| J. Surcharges on Payment of Overdue Powerbills 1. Minimum to PhP 1,000.00 2. PhP 1,001.00 to PhP 2,000.00 3. PhP 2,001.00 to PhP 3,000.00 4. PhP 3,001.00 to PhP 4,000.00 5. PhP 4,001 - above | 50.00 60.00 75.00 100.00 3% of the total amount |

II. COMMISSION DISCUSSIONS and CONCLUSIONS

II.A. DETERMINATION OF TOTAL REVENUE REQUIREMENT

In reaching its conclusions herein, the Commission took into consideration the documents, data, comments and issues submitted by the applicant, oppositors and other interested parties who manifested their respective positions on this present application.

II.A.1. TEST YEAR

The Commission finds ORMECO's proposal to use the test year 2000 in its unbundled rate application acceptable since it is consistent with Rule 15 Section 6 (c) of the Implementing Rules and Regulations (IRR) of the Act. Therefore, the discussions and conclusions that follow are based on Schedule A, adjusted to audited financial statement figures for historical test year 2000.

II.A.2. GENERATION and TRANSMISSION COST

At present, ORMECO is buying power from two (2) sources, namely: National Power Corporation – Small Power Utilities Group (NPC – SPUG) and Mirant (Philippines) Energy Corporation. ORMECO also generates its own power through its mini-hydro owned-generation plant in Dulangan.

The Generation and Transmission charge shall reflect the charge of NPC-SPUG as approved in ERC Order dated December 20, 2002, Case No. 2002-01 [In the Matter of the Application for the Approval of Unbundled Power Rates and Basic Rate Increase in the Small Island Grids, National Power Corporation (NPC) – Applicant]. A separate charge to account for the allowable system loss shall likewise be provided (please refer to Section II.B.2.d. for details). Hence, a distribution utility with system loss that is within the allowable cap can recover from its end-users the total cost of generation. *Annualization*² of billing determinants was applied.

The adjustment made by the Commission to Purchased Power of PhP 105,160,297 pertains to the difference between the proposed purchased power of ORMECO amounting to PhP 183,642,290 and the purchased power cost based on the new rates of NPC-SPUG amounting to PhP 288,802,587.

Records show that ORMECO's average system loss for the years 2000, 2001 and 2002 was 13.18%. The Commission allowed a system loss of 13.18% in the calculation of ORMECO's revenue requirement as discussed in Section II.B.2.d. of this Decision.

² *The annualization of kWh sales is calculated by multiplying the average kWh consumption of a specific customer class by the year-end number of customers.*

Based on the new NPC-SPUG generation and transmission charge, as well as the allowable system loss, the Commission sets ORMECO's unbundled Generation, Transmission and Recoverable System Loss as follows:

| | | |
|-------------------------|------------|--------------------|
| Generation Charge | PhP | 237,508,869 |
| Transmission Charge | | 11,559,604 |
| Recoverable System Loss | | 39,734,114 |
| Total | PhP | 288,802,587 |

ORMECO's approved generation charge shall remain fixed until changes in NPC-SPUG's generation rate are approved and authorized by the Commission pursuant to its Orders dated February 24, 2003 and May 15, 2003, Case Nos. 2003-44 [In the Matter of the Adoption of the Generation Rate Adjustment Mechanism (GRAM) and Incremental Currency Exchange Recovery Adjustment (ICERA)] and 2003-156 [In the Matter of the Application for the Recovery of Fuel and Independent Power Producer Costs under the Generation Rate Adjustment Mechanism (GRAM)]. Any change thereon shall be reflected as deferred charges or credits which shall be recovered through GRAM as discussed in Section II.B.2.b. of this Decision. In the meantime, ORMECO shall discontinue charging the Purchased Power Adjustment (PPA) upon effectivity of the unbundled rates.

II.A.3. PAYROLL

The Commission made an upward adjustment in ORMECO's payroll by PhP 4,374,152 to update it to the current salary level of PhP 42,300,427.

The Commission reviewed the Wage Adjustment Clause (WAC) Formula authorized by the then Energy Regulatory Board through ERB Case Nos. 94-25 and 94-96. The then Board allowed the implementation of the WAC Formula based on three (3) established criteria for it to be classified under automatic adjustment clauses. These are: 1) when such costs are extremely volatile, changing rapidly over a short period of time; 2) when such volatile cost changes represent significant portions of total utility operating expenses; and 3) when such volatile cost changes are beyond the ability of the utility to control.

Analysis shows that the wage adjustments do not warrant an automatic recovery clause. The Commission therefore rules that the application of the WAC Formula be discontinued. The growth in kWh sales will be sufficient for the electric cooperatives to absorb increases in salaries/wages mandated by the wage orders.

II.A.4. OPERATION and MAINTENANCE (less Purchased Power and Payroll)

In general, operating expenses allowed are those which are reasonably incurred in connection with business operations to yield revenue or income. These should be required or necessary in the operation of a utility are recurring, and should redound to the service or benefit of end-users.

The Commission enjoins ORMECO to incur only “prudent and reasonable costs” for inclusion in the determination of retail rates. While a distribution utility is allowed to pass through its costs of purchased power and other reasonable costs to the end-users, it is obligated as a public utility to ensure that its costs of operations, including payroll, are kept at a minimum. The distribution utility must bear in mind that its very nature is that of a service company for its end-users, with a mandate to advocate and transact judiciously for and in their behalf.

“Reasonable costs” may be defined as the cost of those goods and services which, while may not be the lowest in price, need to be incurred with consideration of quality, efficiency, reliability, and security, which are characteristics of the service that should be delivered by the distribution utility. “Prudent costs” demand that the utility ensures that its purchases of goods and services are at their minimum, without sacrificing the foregoing

characteristics. When making a purchase or executing a contract, it cannot simply rely on its right to pass on its costs to its end-users.

As such, the Commission, in fulfillment of the policy of R.A. 9136 to establish a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency, enjoins ORMECO to institute and report to the Commission its respective policies and procedures for cost-cutting and for the transparent and competitive procurement of goods and services.

ORMECO's end-users have a right to receive safe, reliable, and adequate service at a reasonable rate. On the other hand, these end-users should pay their power bills on time to ensure ORMECO's viability. To this end, ORMECO should view a petition for an increase in rates to be the last recourse. In future filings, ORMECO should be reminded that it has the burden of proving that all reasonable and appropriate cost cutting measures have been taken before resorting to a petition to increase rates.

The Commission made a downward adjustment of PhP 16,380,772 on ORMECO's Operation and Maintenance Expenses as follows:

Amounts in the UFR that exceed what are allowed under NEA Guidelines on Benefits, Allowances and Other Incentives to EC Officers and Employees

| | | |
|--|---------|--------------------------|
| Pension and Benefits | 450,000 | |
| Medical Allowance | 230,000 | |
| Consumer Prompt Payment Reclassified to Other Revenue Items | 415,272 | 1,095,272 |
| Decrease in Total Distribution Costs to reduce the resulting Computed OATA to the amount actually applied for by the cooperative | | <u>15,285,500</u> |
| TOTAL ADJUSTMENT | | <u>16,380,772</u> |

The said expenses were excluded for revenue requirement determination. These expenses translate to PhP 0.2383/kWh which the Commission considers material.

For future rate cases, ORMECO will continue to be required to make full disclosure of all its O & M expenses and be responsible in providing documentation to prove the reasonableness and prudence of all its expenditures. ORMECO should ensure that procedures are put in place so that all expenditures that are included in the determination of revenue requirement are adequately documented and that such documentation is reasonably accessible to the ERC.

II.A.5. OTHER REVENUES

The Commission defines Other Revenue Items (ORI) as revenue earned (net of other expenses) by the electric utilities from activity other than sale of electricity.

The Commission encourages ORMECO to improve its financial operations through the development of other related sources of revenue. In order to balance the interests of ORMECO and its end-users and in recognition of the fact that some of the costs incurred in rendering services under ORI have already been included in the determination of revenue requirements, the Commission has adopted the following policy. The ORI that arises from activities not related to the business of the cooperative nor involves the use of its assets will not be deducted from the revenue requirement of the cooperative. The ORI that arises out of related business activities or is asset based will be shared by the cooperative and the end-user by including 50% in revenue requirement.

The total non-asset based ORI which were not deducted from the total revenue requirement amounts to PhP 3,082,714.

The ORI subjected to the 50% rule was computed as follows.

| Particulars | Amount (PhP) |
|-------------------------------------|---------------------|
| Prompt Payment Discount from NPC | 5,163,864 |
| Prompt Payment Discount to Customer | (415,272) |
| Pole Rental | 611,025 |
| Transformer | 67,765 |
| TOTAL | 5,427,382 |
| 50% of the above | 2,713,691 |

The Commission also rules that any interest/dividend income earned will be retained 100% by ORMECO. However, such income should form part of the reinvestment fund and will be used solely for rehabilitation/expansion programs of ORMECO.

II.A.6. DEBT SERVICE

The Commission made an upward adjustment of PhP 13,176,480 to assure that the debt service included in ORMECO's revenue requirement is consistent with NEA's records. The details of the adjustment are shown below.

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| LOANS | PER NEA (PhP) | PER ORMECO (PhP) | VARIANCE (PhP) |
|------------------------|--------------------------|-----------------------------|---------------------------|
| Rural Electrification: | | | |
| LOAN A1 | 663,846 | 663,846 | 0 |
| LOAN A2 | 1,554,356 | 1,554,356 | 0 |
| LOAN B | 840,951 | 840,951 | 0 |
| LOAN D | 1,301,268 | 1,301,268 | 0 |
| LOAN E | 198,844 | 198,844 | 0 |
| LOAN F | 555,816 | 555,816 | 0 |
| LOAN G | 2,458,788 | 2,458,788 | 0 |
| LOAN H | 410,824 | 410,824 | 0 |
| OECF Const | 3,966,844 | 3,263,472 | 703,372 |
| OECF Logistical | 650,688 | 650,688 | 0 |
| Concessional | 347,660 | 347,660 | 0 |
| Mini Hydro – Local | 6,925,020 | | 6,925,020 |
| Mini Hydro – Local | 236,256 | | 236,256 |
| Mini Hydro – Add'l | 458,785 | | 458,785 |
| Mini Hydro – Forex | 4,853,047 | | 4,853,047 |
| TOTAL | 25,422,993 | 12,246,513 | 13,176,480 |

Pursuant to Section 60 of R.A. 9136 and E.O. 119, savings realized by electric cooperatives (ECs) due to the assumption of certain loans by the Power Sector Assets and Liabilities Management Corporation (PSALM Corp.) shall be passed on to ORMECO's end-users. ORMECO applied for a rate reduction under the Guidelines for the Implementation of the Reduction in Rates of the Electric Cooperatives due to Condonation of Debts issued by the Commission on October 21, 2002, as amended on November 15, 2002.

The Commission, in its Order dated March 14, 2003, granted ORMECO a Provisional Authority to reduce its rates by PhP 0.0714/kWh effective on the next billing cycle after receipt of the said Order. The said reduction in rates is likewise shown on the rate schedule provided in the Disposition of this Decision.

II.A.7. REINVESTMENT FUND

ORMECO made a proposal for the provision for reinvestment fund in its unbundling of rates application in the amount of PhP 12,536,859.

The Commission permits a reinvestment fund equivalent to 5% of ORMECO's Gross Revenue to finance expansion and rehabilitation/upgrading of its existing electric power system in accordance with the submitted System Rehabilitation/Upgrading and/or System Loss Reduction Plan. This resulted in an upward adjustment of PhP 6,563,188 in the reinvestment fund account.

One of the main purposes of providing the 5% Reinvestment Fund is for the end-users of ORMECO to shoulder part of their increasing capitalization requirements as outside sources of funding are getting scarce.

The Reinvestment Fund is authorized subject to the following conditions:

- a) This reinvestment fund shall not be used, even temporarily, for any purpose other than for those projects specified in the submitted plan;
- b) The amounts collected for the reinvestment fund, including interest income (as discussed in Section II.A.5.) shall be

placed in a separate account and shall be disbursed in accordance with the plan submitted by ORMECO;

- c) ORMECO is further required to submit a progress report no later than one (1) year after the date of this Decision and every year thereafter using the format prescribed by the Commission. The progress report shall include detailed accounting itemizing total collections, the actual use of all disbursements, and actual current system losses.

Upon review of the progress report, the Commission may issue an order for ORMECO to appear and show cause why it should continue collection of the reinvestment fund; and

- d) ORMECO shall submit a new System Rehabilitation/Upgrading and/or System Loss Reduction Plan covering the period 2004 to 2008, one (1) year after the date of this Decision using the format to be prescribed by the Commission.

II.A.8. REVENUE REQUIREMENT SUMMARY

The table provided below is the comparison of the approved revenue requirement with that proposed by ORMECO:

| | ORMECO Proposal | Adjustments | ERC Approval |
|--------------------------------------|------------------------|--------------------|---------------------|
| Purchased Power PhP | 183,642,290 | 105,160,297 | 288,802,587 |
| Payroll | 37,926,275 | 4,374,152 | 42,300,427 |
| O & M (less PP & Payroll) | 25,469,345 | (16,380,772) | 9,088,573 |
| Debt Service | 12,246,513 | 13,176,480 | 25,422,993 |
| Reinvestment Fund ³ | 12,536,859 | 6,563,188 | 19,100,047 |
| Other Revenue Items | 0 | (2,713,691) | (2,713,691) |
| Total Revenue Requirement PhP | 271,821,282 | 110,179,654 | 382,000,936 |

ORMECO proposed an OATA of PhP 0.1167/kWh using rates of year 2000. The OATA is a measurement tool based on the formula: (Total Revenue Requirement less Existing Revenue) divided by kWh sales. This measurement is not meant to refer to any specific customer class.

The Commission, after considering adjustments of PhP 110,179,654 approves a total revenue requirement of PhP 382,000,936 based on the 2000 equivalent and approves ORMECO's OATA⁴ of PhP 0.1167/kWh for which it asked for. The actual impact to end-users will depend on the level of rates currently being charged. This impact is illustrated in Sec II.B.6. of this Decision.

³ In the UFR, this item is reflected as "Plus Percentage for Cooperative Investment".

⁴ The OATA was computed using existing approved distribution rates (inclusive of current WAC, if any) and unbundled power cost as of November 2003.

II.B. RATE STRUCTURE/DESIGN DETERMINATION

II.B.1 FUNCTIONALIZATION, CLASSIFICATION and ALLOCATION

The functionalization and allocation factors used by ORMECO were the default factors provided for in the UFR issued by the Commission on October 30, 2001. In the case of ORMECO, a number of the default factors were found not to represent the best alternative among possible factors. Thus, the following three (3) default factors used by ORMECO for functionalization and allocation were modified, to wit:

First, the use of Net Plant in Service (PLTSVC-N) as a factor to functionalize and allocate Maintenance for Office and General Plant will cause skewed results by allocating these maintenance costs toward assets not part of such activity. The Commission, therefore, adopted a factor based on Net General Plant (GP-N) as a more reasonable method to allocate maintenance expense associated with general plant.

Second, the factor "Total Operation and Maintenance, Net of Fuel and Purchased Power" (TOMXFP), which was used as a default factor to functionalize costs under outside services, was replaced with "Total Payroll Excluding Administrative and General Salaries" (PAYXAG) in order to remove the possibility of allocating a portion of outside services costs to the transmission function.

Third, since the Commission considered Other Revenue Items (ORI) not included by ORMECO in the calculation of its revenue requirement, it was necessary to functionalize and allocate these amounts. The functionalization factors for ORI which were determined based on direct assignment are as follows:

| Factor Name | Functionalization Factor Description | Total Check | Generation | Transmission | Distribution | Supply | Metering |
|-------------|--------------------------------------|-------------|------------|--------------|--------------|--------|----------|
| ORI | Other Revenue Items | 1.0000 | 0.0000 | 0.0000 | 0.0783 | 0.8983 | 0.0234 |

ORMECO submitted classification of distribution costs into demand and customer-related costs using Minimum Plant Method. This resulted in a 25% - 75% allocation on the average.

II.B.2. DESIGN and CALCULATION OF CHARGES

II.B.2.a. BAPA

The Commission, in the design and calculation of charges, takes note of the existence of the Barangay Power Associations (BAPAs) that were conceptualized by the National Electrification Administration (NEA) for the purpose of strengthening member awareness and involvement in efforts towards the reduction of system loss, improvement of collection efficiency and fortification of the institutional consciousness in the grassroots level. The

creation of BAPAs was also necessitated by the growing number of cooperatives' membership which made it impossible for the cooperatives to physically reach out to all end-users.

The cooperatives are responsible for the energization of the BAPAs while the latter are responsible for the maintenance of the electric lines and other installed equipment, and the reading and billing of respective member end-users. The cooperatives, in this regard, are mandated to grant various incentives to BAPAs, such as three percent (3%) prompt payment discount, rebates on kWh sold, system loss allowance, honorarium for working BAPA officers, or annual cash rewards for outstanding BAPAs and livelihood projects.

The Commission further acknowledges that cooperatives that have instituted BAPAs in their respective franchise areas incur costs with respect to the generation and distribution of power. With reference to the supply and metering functions, the cooperatives generally sustain minimal costs because they only read and bill the BAPAs' mother meters.

In the design and calculation of charges, the Commission did not consider the BAPA as a customer class.

II.B.2.b. GENERATION CHARGE

Consistent with the decision in ERC Case No. 2002-01, In the Matter of the Application for Approval of the Unbundled Power Rates and Basic Rate Increase in the Small Island Grids, National Power Corporation - Applicant, dated December 20, 2002, and the Commission's Orders dated May 15, 2003 under ERC Case No. 2003-156, In the Matter of the Application for the Recovery of Fuel and Independent Power Producer Costs under the Generation Rate Adjustment Mechanism (GRAM), the generation charge to be billed to end-users shall be the NPC – SPUG's approved rate per kilowatt-hour. The NPC-SPUG's approved rate will remain fixed until changes are authorized by the Commission pursuant to its Order dated February 24, 2003 as discussed in Section II.A.2. of this Decision. This allows ORMECO's Generation Charge to remain fixed until such time that NPC-SPUG's approved rate is adjusted, thus, eliminates the need for future Purchased Power Adjustment (PPA).

II.B.2.c. TRANSMISSION CHARGE

The Commission's Order in ERC Case No. 2002-01 dated December 20, 2002 set the transmission charges for the NPC-SPUG without automatic adjustments. Since the transmission rates to be paid by ORMECO are fixed, it is the decision of the Commission to likewise fix the unbundled

transmission rates billed to end-users. The transmission charges approved for billing by ORMECO have been calculated based on the approved transmission rates for NPC-SPUG.

| Transmission Charges | | Residential / BAPA | Commercial | Industrial | Public Buildings | Street Lights |
|----------------------------|---------|-----------------------|------------|------------|---------------------|------------------|
| Demand Charge | PhP/kW | | | 17.60 | | |
| Transmission System Charge | PhP/kWh | 0.1736 | 0.1718 | 0.0637 | 0.1735 | 0.1673 |

II.B.2.d. SYSTEM LOSS CHARGE

The Commission defines system loss for utilities to include technical loss, non-technical loss, and administrative loss or the utility's use of power for its own operations.

The Commission approves the recovery of allowed system loss through the establishment of a separate System Loss Charge in the bill to end-users. The System Loss Charge shall vary from one customer class to another depending on their respective contributions to the system loss. However, due to limited information, the Commission is constrained to adopt a uniform allowable System Loss Charge for all end-users of ORMECO.

The allowed system loss is equal to the average system loss for the years 2000, 2001 and 2002 or the system loss cap, whichever is lower. In

arriving at this decision, the Commission recognizes that the distribution utility faces some risk of over-or under-recovery in the event its load characteristics change through time. The System Loss Charge results in additional unbundled generation costs to be paid by end-users. When system loss is within the allowable cap, the distribution utility shall recover from the end-users all generation and transmission costs. Thus, system loss in excess of the allowable cap shall not be recovered as calculated in Section II.A.2. of this Decision.

On December 8, 1994, Republic Act No. 7832, otherwise known as the Anti-Pilferage Law, was enacted. In July 1995, the ERB promulgated Implementing Rules and Regulations (IRR) under ERB Case No. 95-05, to implement said law. Section 10 of R.A. 7832 and Rule IX, Section 1 of its IRR provide that the recoverable Technical and Non-Technical System Loss should not exceed the fourteen percent (14%) ceiling allowed for year 2000.

The Commission believes that the present cap on Technical and Non-Technical System Loss of 14% should continue to be used. This would, however, be subject to change upon the approval of a new policy by the Commission. The average Technical and Non-Technical System Loss or cap of 14% plus 1% cooperative own use (which should not include personal consumption of ORMECO's Board of Directors, officers and staff), whichever is lower, shall be deducted from total power cost and to be billed separately as System Loss Charge.

The Commission found that ORMECO's 2000 to 2002 average system loss was 13.18% which is lower than the aforementioned cap of 14%. Hence, the Commission used the system loss of 13.18% in the calculation of ORMECO's revenue requirement.

II.B.2.e. DISTRIBUTION CHARGE

The distribution charge shall be billed on a fixed rate per kilowatt-hour for Residential, Commercial, Public Building and Street Lights end-users. In the case of Industrial end-users, distribution charge shall be billed using a combination of a fixed rate per kilowatt (kW) and a fixed rate per kilowatt-hour (kWh).

ORMECO did not propose for distribution wheeling rates. The Commission believes that wheeling rates are parallel to the cost of service functionalized under Distribution. Thus, the Commission orders that the Distribution Charge provided on Rate Schedules be likewise utilized as Distribution Wheeling Charges available to the future contestable market. However, other distribution utilities requesting to wheel power across ORMECO's facilities shall pay wheeling charges equivalent to Distribution Wheeling Charges for Industrial customers.

The Commission's decision to allow a distribution utility to avail of the Distribution Wheeling Charges of another distribution utility is based on the general intent of R.A. 9136 to promote a competitive generation market. Distribution utilities that currently or in the future shall rely in full or in part on

the distribution facilities of another distribution utility should not be held captive by the other distribution utility in the purchase of the unbundled generation. Therefore, distribution utilities are prohibited from bundling or tying the sale of generation or purchased power with the sale of unbundled distribution wheeling service.

II.B.2.f. METERING and SUPPLY CHARGES

The Commission acknowledges that cost-causation rate design principle suggests the recovery of customer-related costs associated with the metering and supply functions through fixed monthly charges. Along with this cost of service principle, however, the Commission also considers rate design impacts across the spectrum of customers within each rate class. Although R.A. 9136 requires the removal of inter-class cross subsidies, the law does not require removal of revenue flows that may be characterized as intra-class cross subsidies. The Commission has the flexibility to consider other factors in determining rate design for a particular class of end-users. Therefore, to mitigate the impact on below-average consumption of residential end-users, the Commission orders ORMECO to use a combination of PhP 5.00 per meter per month and a PhP 0.1340 per kWh rate for the metering function. On the other hand, the Commission orders ORMECO to use a PhP per kWh rate for the supply function. For Commercial, Industrial and Public Building end-users, the metering and supply charges shall be billed on a fixed rate per meter per month and fixed rate per customer per month, respectively. In the case of

Street Lights customers, the metering charge shall only be billed on ORMECO's metered customers. The Supply charge shall be billed on a fixed rate per customer per month for all end-users (except for Residential).

II.B.3. INTER-CLASS CROSS SUBSIDY

II.B.3.a. CROSS SUBSIDY RATE CALCULATION

The inter-class cross subsidies in existing rates are as follows:

| | Total | Residential | Commercial | Industrial | Public Bldgs. | Street Lights |
|---|-------------|-------------|------------|-------------|---------------|---------------|
| New Cost-Based Rev. Req. | 382,000,936 | 252,285,394 | 85,872,684 | 15,979,909 | 21,596,715 | 6,266,234 |
| Existing Rates Revenue | 374,186,096 | 241,078,384 | 85,451,938 | 18,927,039 | 24,253,815 | 4,474,920 |
| Total Change in Revenue | 7,814,840 | 11,207,010 | 420,746 | (2,947,130) | (2,657,100) | 1,791,314 |
| Percentage Change in Revenue | 2.09% | | | | | |
| Normalized Existing Revenue | 382,000,936 | 246,113,282 | 87,236,593 | 19,322,329 | 24,760,354 | 4,568,378 |
| Inter-Class Cross - Subsidy Amounts (PhP) | 0 | (6,172,112) | 1,363,909 | 3,342,420 | 3,163,639 | (1,697,856) |
| Class Billing Determinants (in kWh) | 66,991,250 | 43,233,846 | 15,269,774 | 3,335,556 | 4,349,563 | 802,511 |
| Inter-Class Cross Subsidy Rates (PhP / kWh) | | (0.1428) | 0.0893 | 1.0021 | 0.7273 | (2.1157) |

II.B.3.b. CROSS SUBSIDY REMOVAL

Section 74 of R.A. 9136 and Rule 16, Section 5 of its Implementing Rules and Regulations provide that the ERC shall issue a scheme for phasing out all cross subsidies including subsidies within Grids, between Grids, and between classes of end-users. The phasing out period shall not exceed three (3) years from the establishment of the Universal Charge which may be extended for a maximum period of one (1) year subject to certain conditions.

In the instant case, the Commission will order the cross subsidy removal process at a later date following the establishment of the Universal Charge. Until such time, ORMECO will continue to charge the inter-class cross subsidy rates set forth in Section II.B.3.a. above.

II.B.4. LIFELINE RATE and LEVEL

Section 4 (hh) of the R.A. 9136 defines Lifeline Rate as the subsidized rate given to low-income captive market end-users who cannot afford to pay at full cost. Pursuant to Section 73 of R.A. 9136, the Commission hereby sets the level of lifeline consumption and rate.

In determining the lifeline level of consumption to be provided to the marginalized end-users, the Commission calculated the probable load requirement of typical low-income end-users by considering two (2) lighting facilities at 20 Watts each and a 50-Watt radio that are being used for a reasonable number of hours. In setting the maximum level of lifeline consumption, the Commission may adjust the minimum level of consumption and/or level of the discount so as to maximize the benefit to low-income end-users while keeping the costs associated with such subsidy between PhP 0.05 and PhP 0.10 per kWh. Thus, the Commission sets the lifeline consumption maximum level of 25 kWh for ORMECO. The Commission considers the impact that the subsidized Lifeline Rates will have on other end-users who must carry the costs associated with such subsidy. This fact

combined with the desire to maximize the benefit to as many marginalized end-users as possible has led the Commission to adopt the following graduated scale for lifeline discount for ORMECO. The graduated scale is also based on the recognition that individual end-user consumption may likely vary from month to month.

| | | |
|-----------|---|-----|
| 15 kWh | - | 50% |
| 16 kWh | - | 40% |
| 17 kWh | - | 30% |
| 18 kWh | - | 20% |
| 19 kWh | - | 10% |
| 20-25 kWh | - | 5% |

ORMECO shall apply these discounts to the following residential charges: Generation, Distribution, Supply, Metering and System Loss. In a given billing period, an end-user at any of the above-consumption levels shall be given the specified corresponding discount on each of these rate components. An end-user with a level of consumption exceeding 25 kWh in a particular billing period shall not be entitled to any discounted lifeline rate for said period.

The cost of subsidy to lifeline end-users shall be passed on to all non-lifeline end-users. For ORMECO, the lifeline discounts result in a Lifeline Rate Subsidy by other end-users equal to PhP 0.0616/kWh.

II.B.5. OTHER CHARGES

ORMECO's additional submission to this Commission of its existing Other Charges as previously presented was considered in the determination of its revenue requirement. The revenues derived from these charges were appropriately deducted from the determination of the revenue requirement allowed to ORMECO.

The Other Charges of ORMECO are hereby pegged at their existing levels until such time that the Commission sets new rates on the same. Further, ORMECO is ordered to make a compliance filing on its Other Charges a year from the date of this Decision using a format to be prescribed by the Commission.

The compliance filing for the approval of Other Charges shall include rates that are cost-based, as well as, all supporting cost justification for the rates, including but not limited to the amount of actual time and wages of employees performing each task encompassed by each type of Other Charges.

II.B.6. ESTIMATED IMPACT ON AN AVERAGE RESIDENTIAL END-USER

A comparison of the estimated impact of all adjustments on the revenue requirement on the monthly bill of an average residential end-user consuming 80 kWh a month using rates based on ORMECO's actual existing

rates as of November 2003 against the unbundled rates approved by the Commission is shown below.

| Based on Actual Existing Rates | | | Based on ERC Approved Unbundled Rates | | | |
|--------------------------------|----------|---------------|--|--------|----------|---------------|
| | PhP/kWh | Amount (PhP) | | | PhP/kWh | Amount (PhP) |
| Basic Rate | 3.7840 | 302.72 | Generation Charges: | | 3.5454 | 283.63 |
| PPA | 1.9451 | 155.61 | Generation System Charge | 3.5454 | | |
| WAC | 0.0536 | 4.29 | Transmission System Charge | | 0.1736 | 13.89 |
| PAR | (0.3000) | (24.00) | Distribution Charge | | 1.0447 | 83.58 |
| Univ. Charge | | | System Loss Charge | | 0.5931 | 47.45 |
| Missionary Electrification | 0.0373 | 2.98 | Supply Charge | | 0.2874 | 22.99 |
| Environmental Share | 0.0025 | 0.20 | Metering Charges: Per Customer Per Month Per kWh | | 0.1340 | 5.00 10.72 |
| Loan Condonation | (0.0714) | (5.71) | Inter-Class Cross Subsidy | | (0.1428) | (11.42) |
| | | | Universal Charge | | | |
| | | | Missionary Electrification Charge | | 0.0373 | 2.98 |
| | | | Environmental Share | | 0.0025 | 0.20 |
| | | | Lifeline Rate[(Discount)/Subsidy] | | 0.0616 | 4.93 |
| | | | Power Act Reduction | | (0.3000) | (24.00) |
| | | | Loan Condonation | | (0.0714) | (5.71) |
| TOTAL BILL | | 436.09 | TOTAL BILL | | | 434.23 |
| PhP/kWh | | 5.4511 | PhP/kWh | | | 5.4279 |

DISPOSITION

WHEREFORE, the foregoing premises considered, it is hereby decided as follows:

1. To approve the unbundled schedule of rates of ORMECO, to be effective on the first billing cycle thirty (30) days after receipt of this Decision, to wit:

| | Residential | Commercial | Industrial | Public Bldgs. | Street Lights |
|---|-------------|------------|------------|---------------|---------------|
| Generation Charges: | | | | | |
| Generation System Charge PhP/kWh | 3.5454 | 3.5454 | 3.5454 | 3.5454 | 3.5454 |
| Transmission Charges: | | | | | |
| Demand Charge PhP/kW | | | 17.60 | | |
| Transmission System Charge PhP/kWh | 0.1736 | 0.1718 | 0.0637 | 0.1735 | 0.1673 |
| System Loss Charge PhP/kWh | 0.5931 | 0.5931 | 0.5931 | 0.5931 | 0.5931 |
| Distribution Charges: | | | | | |
| Demand Charge PhP/kW | | | 17.60 | | |
| Distribution System Charge PhP/kWh | 1.0447 | 0.6809 | 0.3523 | 0.4954 | 2.9462 |
| Supply Charges: | | | | | |
| Retail Customer Charge PhP/Customer/ Mo. | | 21.77 | 25.39 | 21.78 | 21.67 |
| Supply System Charge PhP/kWh | 0.2874 | | | | |
| Metering Charges: | | | | | |
| Retail Customer Charge PhP/Meter/ Mo. | 5.0000 | 142.45 | 291.22 | 20.22 | 23.59 |
| Metering System Charge PhP/kWh | 0.1340 | | | | |
| Inter-Class Cross Subsidy Charge PhP/kWh | (0.1428) | 0.0893 | 1.0021 | 0.7273 | (2.1157) |
| Universal Charge: | | | | | |
| Missionary Elect. Charge PhP/kWh | 0.0373 | 0.0373 | 0.0373 | 0.0373 | 0.0373 |
| Environmental Share PhP/kWh | 0.0025 | 0.0025 | 0.0025 | 0.0025 | 0.0025 |
| Lifeline Rate (Discount)/Subsidy PhP/kWh | 0.0616 | 0.0616 | 0.0616 | 0.0616 | 0.0616 |
| Loan Condonation PhP/kWh | (0.0714) | (0.0714) | (0.0714) | (0.0714) | (0.0714) |
| Power Act Reduction PhP/kWh | (0.3000) | | | | |

2. To order ORMECO to comply with the following:

- a) Discontinue charging the PPA upon effectivity of the approved unbundled rates. Any change in the cost of power purchased shall be reflected as deferred charges or credits which shall be recovered through GRAM;

- b) Discontinue the application of the Wage Adjustment Clause (WAC) formula upon effectivity of the approved unbundled rates.
- c) Bill PhP 0.0373/kWh representing the missionary electrification portion of the Universal Charge in accordance with the Decision of the Commission in ERC Case No. 2002-165 (In the Matter of the Petition for the Availment from the Universal Charge the Share for Missionary Electrification, NPC-SPUG, Applicant);
- d) Bill PhP 0.0025/kWh representing the environmental portion of the Universal Charge in accordance with the Decision of the Commission in ERC Case No. 2002-194 (In the Matter of the Petition for the Availment from the Universal Charge the Environmental Share/Charge for the Rehabilitation and Management of Watershed Areas, NPC-SPUG, Applicant);
- e) Bill its respective end-users using a billing format which contains at least the rate elements provided in Annex A of this Decision upon effectivity of the approved unbundled rates. The rate elements provided in Annex A should appear on the end-users bill even if the rate elements currently have a rate of zero or have not yet been determined by the Commission;

- f) Inform the end-users within its franchise area of the said approved unbundled rates not later than thirty (30) days after receipt of this Decision;
- g) Submit for verification and confirmation purposes on or before the twentieth (20th) day of the month following the effectivity of the approved unbundled rates and every month thereafter:
 - 1) five (5) sample bills for each end-user class;
 - 2) copy of bills from the generation and transmission companies; and
 - 3) Monthly Financial and Statistical Reports (MFSRs), complete with all related schedules;
- h) Make a formal application with the Commission for the approval of existing or future contracts with any entity for the wholesale purchases of power not yet approved by the Commission;
- i) Make a formal application to continue the use of Other Charges within one (1) year from date of this Decision using a format to be prescribed by the Commission;
- j) File a progress report on the reinvestment fund no later than one (1) year after the date of this Decision and every year thereafter, using the prescribed formats provided in Annexes B & C of this Decision. The report shall include detailed

accounting of actual collections and deposits (including interest/dividend income), specific transactions and withdrawals for all disbursements, and actual current system losses;

- k) Submit a new System Rehabilitation/Upgrading and/or System Loss Reduction Program covering the period 2004 to 2008, no later than one (1) year after the date of this Decision using a format to be prescribed by the Commission; and
- l) Institute policies and procedures for cost-cutting and transparent and competitive procurement of goods and services and submit a report thereon to the Commission within six (6) months from receipt of this Decision.

SO ORDERED.

Pasig City, January 13, 2004.

LETICIA V. IBAY
Officer-In-Charge

OLIVER B. BUTALID
Commissioner

CARLOS R. ALINDADA
Commissioner

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