

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

**IN THE MATTER OF THE  
APPLICATION FOR APPROVAL OF  
THE REVISED RATE SCHEDULES IN  
COMPLIANCE WITH SECTION 36 OF  
REPUBLIC ACT NO. 9136 AND ERC  
ORDER DATED OCTOBER 30, 2001,  
WITH PRAYER FOR PROVISIONAL  
AUTHORITY.**

**ERC CASE NO. 2001-951**

**IBAAN ELECTRIC AND ENGINEERING CORPORATION  
(IEEC),**

**x-----x**

**D E C I S I O N**

Before the Commission for resolution is the application filed on December 26, 2001 by Ibaan Electric and Engineering Corporation (IEEC) for approval of its revised rate schedules in compliance with Section 36 of Republic Act No. 9136 and ERC Order dated October 30, 2001, with prayer for provisional authority.

Having found the application sufficient in form and substance with the required fees having been paid, an Order and a Notice of Public Hearing were issued both dated February 7, 2002 setting the same for initial hearing on March 4 and 5, 2002.

In the same Order, IEEC was directed to publish at its own expense, the Notice of Public Hearing twice for two (2) successive weeks in two (2) newspapers of general circulation in the Philippines, at least two (2) weeks before the date of initial hearing.

Copies of the application, the Order and the Notice of Public Hearing were furnished the Office of the Solicitor General (OSG), the Commission on Audit (COA) and the Committees on Energy of both Houses of Congress who were requested to have their respective duly authorized representatives present at the initial hearing. The Offices of the City/Municipal Mayors within the IEEC's franchise area were likewise furnished with copies of the Order and the Notice of Public Hearing for the appropriate posting thereof on their respective bulletin boards.

On February 27, 2002, IEEC filed an "Urgent Motion for Postponement" praying that the scheduled hearings on March 4 and 5, 2002 be cancelled and reset to a later date in view of its failure to comply with the Commission's publication of notice requirements. Consequently, the Commission in an Order dated February 28, 2002 granted said motion and reset the initial hearing of this case on April 16, 2002. In the same Order, IEEC was directed to publish the Notice of Public hearing indicating therein the new date of hearing.

At the initial hearing of this case on April 16, 2002, only the IEEC appeared. No oppositor appeared nor was there any opposition registered therein.

At the said hearing, IEEC presented its proofs of compliance with the Commission's publication and posting of notice requirements duly marked as Exhibits "A" to "B-3", inclusive. IEEC published The Notice of Public Hearing in the Philippine Daily Inquirer and Philippine Star dated March 4 and 31, 2002. Thereafter, IEEC presented its first witness, Ms. Alicia de Leon, IEEC's Bookkeeper who testified on the schedules submitted by the IEEC in support of the application. In the course thereof, several documents were presented and subsequently marked as Exhibits "C" to "L", inclusive. Said direct examination having been terminated, the Commission propounded clarificatory questions on the same witness.

IEEC then presented its second witness, Mr. Manolito Saludo, who testified on the technical aspect of the application. In the course thereof, IEEC was directed to submit, within five (5) days from said date of hearing, a detailed breakdown of its construction work in progress.

After which, IEEC moved that it be allowed to orally make its formal offer of exhibits subject to the submission of additional documents which the Commission may require. Said motion was granted by the Commission. Accordingly, IEEC made an oral formal offer of evidence, which was admitted by the Commission for the purposes for which they were being offered.

## **I. SUMMARY OF IEEC's APPLICATION**

### **I.A. REVENUE REQUIREMENT**

IEEC proposes a revenue requirement of PhP 65,740,304 based on the historical test year 2000 as evidenced by its submitted Overall Average Tariff Adjustment (OATA) to increase its rates by PhP 0.4418 as shown below, to wit:

**TABLE 1**

<b>Account Name</b>	<b>Adjusted Electric PhP</b>
Purchased Power <sup>1</sup>	47,833,823
Payroll	5,338,144
O & M (net of Purchased Power & Payroll) <sup>2</sup>	5,537,012
Depreciation & Amortization	2,936,629
Income Taxes <sup>3</sup>	31,469
Other Expenses	-
Return on Rate Base <sup>4</sup>	<u>4,063,226</u>
Revenue Requirement	65,740,304
Existing Revenue	<u>60,512,387</u>
Required Increase (Decrease)	<u>5,227,917</u>
Required Increase (Decrease) per kWh	<u>0.4418</u>

<sup>1</sup> Gross of NPC discounts  
<sup>2</sup> General & Administrative expenses & customer information expenses including franchise tax  
<sup>3</sup> Actual income tax for the year 2000  
<sup>4</sup> Computed at a rate of return of 10.19%

### **I.A.1 OPERATING REVENUES**

IEEC reported a total operating revenue of PhP60,512,387 for the year 2000, inclusive of PhP4,702,107 normalization adjustment. The actual revenue was normalized to reflect the twelve months operating income due to breakdown of 5MVA substation and increase in revenue amounting to PhP 4,087,103 due to PhP

0.34/kwh increase provisionally approved under ERB Case No. 2001-20, calculated as follows:

**TABLE 2**

Customer Class	Actual Revenue 11 months PhP	Adjustment Add'l Inc. for year 2000 PhP	w/Inc of P0.34/ERB Case#2001-20 PhP	Adjusted Revenue 12 months PhP
Residential	30,296,989	2,754,272	2,431,332	35,482,593
Commercial	10,642,634	967,512	794,312	12,404,458
Industrial	10,517,019	956,093	840,953	12,314,064
Streetlights	266,536	24,231	20,505	311,271
<b>TOTAL</b>	<b>51,723,178</b>	<b>4,702,107</b>	<b>4,087,103</b>	<b>60,512,387</b>

**I.B. RATE BASE**

IEEC proposed that Schedule A (Historical Cost) be used as basis in the determination of its Rate Base, computed as follows:

**TABLE 3**

	<b>RATE BASE (PhP) – Schedule A</b>			
	Total Company	Non Electric	Electric Only	Electric Adj. Adjust. Electric
Distribution Plant	34,137,269		34,137,269	- 34,137,269
General Plant	<u>3,428,171</u>		<u>3,428,171</u>	= <u>3,428,171</u>
<b>Total Plant in Service</b>	<b><u>37,565,440</u></b>		<b><u>37,565,440</u></b>	= <b><u>37,565,440</u></b>
<b>Accumulated Depreciation</b>				
Distribution Plant	7,148,624		7,148,624	- 7,148,624
General Plant	<u>1,637,031</u>		<u>1,637,031</u>	= <u>1,637,031</u>
<b>Total Accum. Depreciation</b>	<b><u>8,785,655</u></b>		<b><u>8,785,655</u></b>	= <b><u>8,785,655</u></b>
<b>Net Plant in Service</b>	<b><u>28,779,785</u></b>		<b><u>28,779,785</u></b>	= <b><u>28,779,785</u></b>
Plant Held for Future Use	-		-	
Materials & Supplies	887,637		887,637	- 887,637
Cash Working Capital	8,943,064		8,943,064	668,821 9,611,885
Construction Work in Progress	<u>1,255,009</u>		<u>1,255,009</u>	1,255,009
<b>TOTAL RATE BASE</b>	<b><u>39,865,495</u></b>		<b><u>39,865,495</u></b>	<b>668,821 40,534,316</b>

**I.C. WEIGHTED AVERAGE COST OF CAPITAL (WACC)**

**TABLE 4**

Component	Amount as of 12/31/00	Component as % of Total	Component Cost of Capital	Weighted Cost of Capital
Accounts Payable-Loans	22,802,478	48.44%	8.64%	4.19%
Notes Payable	4,274,525	9.08%	10.00%	0.91%
Total Debt	27,077,003	57.52%		5.09%
Common Equity	20,000,000	42.48%	12.00%	5.10%
Total	<u>47,077,002</u>	<u>100.00%</u>	-	<u>10.19%</u>
Rate Base				40,534,316
Return on Rate Base				4,063,226

**I.D. RATE STRUCTURE/ DESIGN**

IEEC alleged that its unbundled rate proposal is consistent with the Commission's Uniform Filing Requirements (UFR). It therefore proposed to adopt and apply for the approval of the following rate schedules:

<u>Rate Schedule</u>	<u>Proposed Rates per kWh</u>
Residential	
Distribution Charge	PhP0.8504/kWh
Supply Charge – Retail	0.2525/kWh
Supply Charge – Metering	0.5355/kWh
Residential Wheeling Service	
Distribution Charge	1.1029/kWh
Commercial	
Distribution Charge	1.5986/kWh
Supply Charge – Retail	0.0535/kWh
Supply Charge – Metering	0.1201/kWh
Commercial Wheeling Service	
Distribution Charge	1.6521/kWh
Industrial	
Distribution Charge	1.6999/NCP kW
Supply Charge – Retail	0.0023/kWh

Supply Charge – Metering	0.0134/kWh
Industrial Wheeling	
Distribution Charge	1.6999/NCP kW
Streetlights	
Distribution Charge	1.2436/kWh
Supply Charge – Retail	0.1246/kWh
Supply Charge – Metering	0.2685/kWh

**I.E. FUNCTIONALIZATION & ALLOCATION**

The functionalization and allocation factors used by IEEC were the default factors provided for in the UFR prescribed by the Commission.

**I.E.1 Generation and Transmission Charge**

IEEC proposed the adoption of a Generation and Transmission Charge formula for the following customer classes in order to recover its power cost, franchise tax, system losses and company use:

For customer with-out demand meter

$$\text{Generation/Transmission Charge} = \frac{A}{B - (C + C1 + C2)} \times \frac{1}{1 - FT}$$

Where:

- A = Total Cost of Power
- B = KWh purchased in previous month
- C = System loss (=14%) in KWh
- C1 = Company used in KWh
- C2 = Lifeline KWh Consumption
- FT = National and Local Franchise Tax

For customer with demand meter

$$\text{Generation/Transmission Charge} = \frac{A}{B - (C + C1 + C2)} \times \frac{1}{1 - FT}$$

Where:

A = Total Cost of Power Less Demand Charge (with Demand Meter)

B = KWh purchased in previous month

C = System loss (=14%) in KWh

C1= Company used in KWh

C2= Lifeline KWh Consumption

FT = National and Local Franchise Tax

**I.E.2. LINE LOSSES**

IEEC proposed to recover a line loss of 14% through the proposed Generation and Transmission charge formulas set forth in Section I.D.1 above. IEEC's average system loss for the year 2000 was 20.99%.

**I.E.3 DISTRIBUTION CHARGE**

IEEC designed its Distribution Charge to all its customer classes by dividing the computed revenue requirement per customer class by kilowatt-hour sales as billing determinant which resulted to peso per kilowatt-hour rate. IEEC used the normalized kilowatt-hour sold for the year 2000 in the determination of distribution charges.

**I.E.4 SUPPLY AND METERING CHARGES**

Consistent with the distribution charge, IEEC calculated its Supply and Metering Charges to all its customer classes by dividing the computed revenue

requirement per customer class by the normalized kilowatt-hour sales as billing determinant which resulted to a peso per kilowatt-hour rate. IEEC proposed the peso per kilowatt-hour for supply and metering charges because the said utility is very small and using a fixed amount per month will adversely affect its small end-users.

**I.E.5 INTER-CLASS CROSS SUBSIDY**

IEEC indicated the amount of cross subsidies for each type of customer but did not propose a scheme for the removal thereof.

**TABLE 5**

Customer Classes	Total Revenue Requirement (PhP)	Existing Revenues (PhP)	Inter-class Cross Subsidies (PhP)
Residential	38,857,362	38,593,228	264,134
Commercial	13,007,064	13,419,674	(412,610)
Industrial	13,548,280	13,389,924	158,356
Streetlights	327,598	337,489	(9,891)
	65,740,304	65,740,316	(12)

**I.E.6 LIFELINE RATE AND LEVEL**

IEEC proposed a maximum energy consumption of 10 kWh for marginalized end-users which it determined as those using one 50 watts incandescent bulb, one 20 watts fluorescent lamp and one 13 watts convenient outlet operated for 4 hours per day. The proposed lifeline rate per kWh is as follows:

	<u>PhP/kWh</u>
Distribution	0.8504
Meter	0.5355
Supply	<u>0.2525</u>
Total	<u>1.6384</u>

**I.E.7 OTHER CHARGES/NON-RECURRING RATES**

IIEC proposed the following other charges and or non-recurring charges, to wit:

PARTICULARS	SERVICE FEE <u>(PhP/unit)</u>
1. Reconnection at Service Drop	20.00
2. Reconnection due to Withdrawal of Meter	20.00
3. Transfer of Meter Location	20.00
4. Replacement of Meter	20.00
5. New connection – Single phase meter	20.00
6. New connection – Three phase meter	75.00
7. Relocation of Secondary Pole	Actual cost of Labor
8. Service Wire Down Secondary Wire	20.00/wire
9. Service Wire Down Primary Wire	75.00/wire
10. Bump damaged to pole due to Accident	Actual cost of labor
11. Calibration of Watt-hour Meter (as requested by customers)	20.00
12. Installation/Dismantling of Transformer (Private Construction)	Actual Cost of labor

**II. COMMISSION’S DISCUSSIONS AND CONCLUSIONS**

**II.A. DETERMINATION OF THE TOTAL REVENUE REQUIREMENT**

**II.A.1 TEST YEAR**

The Commission finds IIEC’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 R.A. 9136. However, in this particular case, the Commission ruled that in the absence of an appraisal report by

an independent appraiser, Schedule "A" (historical cost by function) instead of submitted "Schedule B"(re-valued cost by function) was used in the determination of the applicant's unbundled rate. The discussions and conclusions that follow are based on Schedule A.

## **II.A.2 GENERATION AND TRANSMISSION COSTS**

### **Generation Cost**

The Commission updated the generation cost based on the most recent approved NPC rate, i.e., ERC Case No, 2003-291 (In the Matter of the Application for the Approval of the Revised Unbundled Generation Tariffs, National Power Corporation (NPC) and Power Sector Assets and Liabilities Management (PSALM) – applicants) Order dated September 29, 2003. Notably, the Commission approved the adoption of the Incremental Currency Exchange Rate Adjustment (ICERA) in ERC Case No. 2003-498, Order dated December 4, 2003 (NPC and PSALM – Applicants). The Commission directed NPC and PSALM to refund to its customers the Deferred Accounting Adjustment (DAA) and FOREX Correction for Luzon amounting to PHP0.0065 per kWh within a period of six months starting December 2003 to May 2004.

### **Transmission Cost**

The Commission's Decision in ERC Case No. 2001-901 dated June 26, 2002 and Order dated September 20, 2002 sets the transmission charges for the TRANSCO without any provision for an automatic adjustment thereof. Since the transmission rates to be paid by IEEC are fixed, it is the decision of the Commission to likewise fix the unbundled transmission rates to be billed to end-users. The transmission charges approved for billing by IEEC have been calculated based on the approved TRANSCO rates, which include cross subsidy elements to be phased out over a three-year period.

Based on records, IEEC is buying power only from the National Power Corporation (NPC). Thus, the Generation and Transmission charges shall reflect the

power supplier generation charges and transmission charges of the National Transmission Company (TRANSCO) as approved in ERC Orders dated September 6 and 20, 2002, and ERC Case No. 2001-901 (In the Matter of the Application for the Approval of the Revised Unbundled Power Rates, National Power Corporation (NPC) – Applicant). The generation charge reflects the average weighted cost of power purchased from NPC.

The total purchased power cost proposed by IEEC in its application amounting to **PhP47,833,823** (total company) was adjusted to reflect the following:

a. System Loss

- The Commission decided to retain the system loss cap prescribed under Rule IX Section 1 of the Implementing Rules of Republic Act No. 7832 pending the conduct of a comprehensive study on the matter. Hence, the Commission sets the maximum allowable cap for system loss at 9.5% instead of the 14% proposed herein by IEEC and allowed actual company usage or 1% of total kilowatthour purchased, whichever is lower. In this case, IEEC’s actual company usage was 0.20% for the year 2000 which is less than the allowable cap of 1%.
  
- In view of the aforementioned system loss cap, the Commission disallows system loss of PhP1,724,850 for the test year, computed as follows:

**Table 6**

<u>Particular</u>	<u>%</u>	<u>Amount</u>
Actual system loss & company use (20.99%+ 0.2%)	21.19	PhP6,294,424
Recoverable system Losses and company use (9.5% + 0.2%)	9.70	4,569,573
Disallowed system loss	11.49	PhP 1,724,850

- b. The Commission considered the normalization adjustments made by IEEC (as discussed in Section I.A.1) and since power rate are to be applied prospectively, the power costs was updated to the most recent levels available, i.e., September 2003 supply month.

The total adjusted purchased power cost after considering the aforesaid adjustments amounted to PhP46,712,211, computed as follows:

**Table 7**

Purchased Power Cost per UFR		PhP47,833,823
Add/(Deduct): Adjustments		
Excess system loss	(PhP1,724,850)	
Increase in Power Cost	<u>603,238</u>	<u>(1,121,612)</u>
<b>Adjusted Power Cost</b>		<b>PhP46,712,211</b>

Based on the new generation and transmission charges, as well as the allowable system loss, the Commission sets IEEC's unbundled Generation, Transmission and recoverable System Loss as follows:

**TABLE 8**

Generation Charge	PhP30,984,840
Transmission Charge	11,157,797
Recoverable Systems Loss & Company Use	4,569,573
<b>Total</b>	<b>PhP46,712,211</b>

IEEC's approved generation charge shall remain fixed until changes in NPC's generation rate are approved and authorized by the Commission pursuant to its Order dated February 24, 2003, ERC Case No. 2003-44 (GRAM) and ERC Case No. 2003-498, Order dated December 4, 2003. In view thereof, the Commission does not foresee the need for the Purchased Power Adjustment (PPA) clause. Towards this end, the Commission hereby directs IEEC to discontinue the implementation of its Purchased Power Adjustment Clause (PPA) upon the effectivity of the herein approved unbundled rates.

**II.A.3 Operation and Maintenance (excluding Power Cost and Payroll)**

The general criteria in the evaluation of expenses to be allowed for recovery are: 1) that the expense is needed in the operation of the utility; 2) it is recurring;

and 3) it redounds to the benefit of the utility's customers (Public Service Commission [PSC] Decision in Cases Nos. 85889, 85890 and 89893). The Commission enjoins IEEC to incur only "prudent and reasonable costs" for inclusion in the determination of retail rates. While a distribution utility enjoys the benefit of passing its costs of purchased power and other reasonable costs to the consumer, 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 as a service oriented company, its mandate is to advocate and transact judiciously for and in behalf of its consumers.

"Reasonable costs" refers to the costs 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 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, a utility cannot simply rely on its right to pass on its costs to its consumers. As such, the Commission, in fulfilment of the policy of the EPIRA to establish a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency, enjoins IEEC to institute and report to the Commission their respective policies and procedures for cost-cutting and the transparent and competitive procurement of goods and services.

IEEC's customers have a right to receive safe, reliable, and adequate service at a reasonable rate. To this end, IEEC should view a petition for an increase in rates to be the last recourse. In future filings, IEEC 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.

Upon review of the components of the expenses included in the revenue requirement, the Commission made a downward adjustment of PhP2,799,669, to Operation and Maintenance (O&M) Expenses as follows:

**TABLE 9**

Particulars	Amount (PhP)
Interest Expense	1,970,795
Franchise Tax*	828,874
<b>TOTAL</b>	<b>2,799,669</b>

\* see discussion on 11.A.3.2 Franchise Tax

### **II.A.3.1 Interest Expense**

Rule 15 Section 5 (ii) of the Implementing Rules and Regulation of Republic Act No. 9136 specifically states that “interest expenses are not allowable deduction from permissible RORB”.

### **II.A.3.2 Franchise Tax**

Franchise taxes shall appear as a separate line item on the customers’ bills as a percentage of the total monthly electricity charges. Given this rate design, it is appropriate to remove from the revenue requirement the amount associated with franchise tax. Since such taxes are being reclassified out of operations and maintenance expenses into a separate category, this item which amounts to P828,874 is excluded from the O & M expenses.

### **II.A.3.3 Income Tax**

The finality of the Supreme Court Decision in G.R. Nos. 141314 and 141369 dated April 9, 2003 affirms that for ratemaking purposes under the RORB methodology, income tax payment should not be recovered from customers as operating cost.

In view of the above, income tax payments in the amount of PhP31,469 were excluded from IEEC’s revenue requirement.

## **II.B. RATE BASE**

### **II.B.1 Construction Work in Progress (CWIP)**

IIEC's CWIP per book amounts to PhP1,255,009 as of December 31,2000. However, supplemental documents submitted by IIEC provides those projects accounted for as CWIP in December 2000 are already 100% completed and in service as of December 2003. Thus, the Commission allows 100% of the proposed CWIP with a total amount of PhP1,255,009. (secure confirmation from IIEC that said CWIP is 100% in service)

### **II.B.2 Allowance for Cash Working Capital**

Working capital is money a business must have available to meet payroll and expenses until customers have paid for the service or product. Utilities are usually allowed, as part of their rate base, an amount for working capital to cover expenses during the time it takes for the customers to use the service, be billed for it and collect payments.

IIEC has included an amount equal to two (2) months cash operating and maintenance expenses including purchased power costs as the allowance for cash working capital.

The cash working capital allowance included in the rate base should approximate the cash requirements based on an estimate of the net lag in cash flow. In order to refine the application of the formula used in past proceedings, a more detailed review of the actual lag in cash flow associated with the payments for purchased power and the inflow of cash from IIEC's customers was undertaken. With respect to the outflow of cash associated with the payments for purchased power, it was determined that the time from the provision of service to the outflow of funds can be calculated as follows:

15 days	Average billing cycle
5 days	Meter reading and bill preparations
<u>10 days</u>	Approximate time before payment is due
<u>30 days</u>	Total

Therefore, IEEC has an average of approximately thirty (30) days from the time service is provided until payment is due.

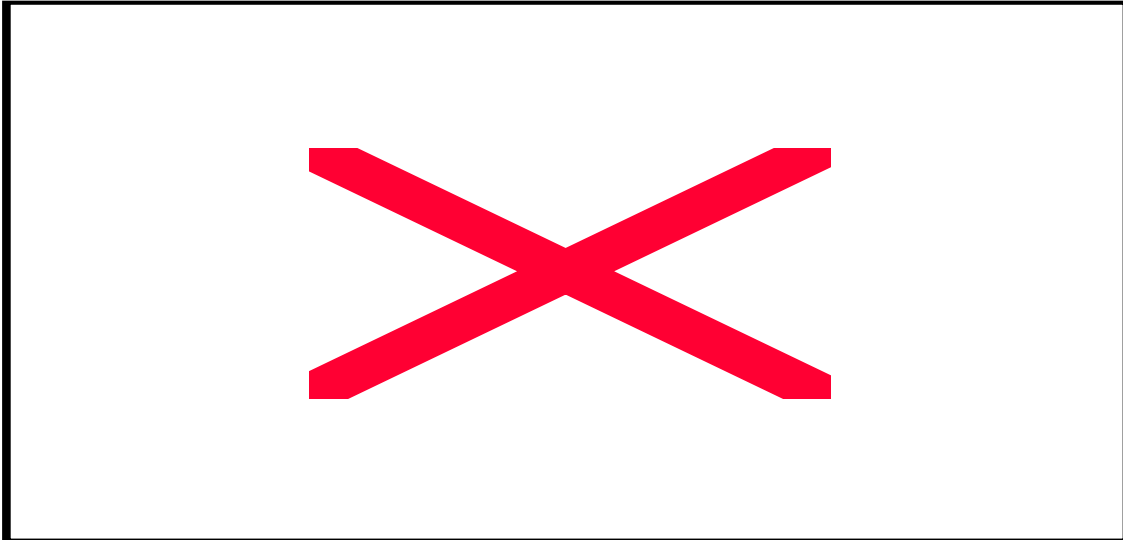
With respect to the collection of payments from its customers, and the time from the provision of service to the inflow of funds can be calculated as follows:

15 days	One half of the billing cycle
20 days	Meter reading and bill preparation and time required to collect the customer's bill without disconnection based on the service contract
<u>5 days</u>	Processing time
<u>40 days</u>	Total

Therefore, IEEC waits for an average of approximately forty (40) days before it receives payment for the services provided. With respect to purchased power it appears that the actual net lag days is approximately 10 days only (40 less 30) and not the 60 days assumed in the application of the formula. IEEC's customers who do pay on time should not be penalized because other customers fail to comply with IEEC's payment schedule. If additional finance costs are incurred because of late payment of bills, those costs should be recovered in the form of penalties to the late paying customers and not as additional cash working capital to be paid by all customers. This modification would reduce the cash working capital allowance of IEEC by PhP7,007,671.

The following table summarizes the Cash Working Capital allowed by the Commission as compared with the calculation made by IEEC.

**TABLE 10: Cash Working Capital**



**II.B.3 Materials and Supplies**

Reported materials and supplies per book in the amount of PhP887,637 were adjusted downward to PhP809,834 to exclude the amount of PhP77,803 pertaining to office supplies. The same will form part of the operating expenses which are entitled to the two (2) months allowance for cash working capital.

**II.B.4 Summary of Rate Base**

The following summarizing the rate base allowed by the Commission:

**TABLE 11**

	<b>Per IEEC (Sch A)</b>	<b>Adjustments</b>	<b>ERC</b>
<b>Net Plant in Service</b>	<b>28,779,785</b>	-	<b>28,779,785</b>
Plant Held for Future Use	0	-	0
Construction Work in Progress	1,255,009	-	1,255,009
Materials & Supplies	887,637	(77,803)	809,834
Cash Working Capital (see table 10)	9,611,885	(7,007,671)	2,604,214
<b>Total Rate Base</b>	<b>40,534,316</b>	<b>(7,085,474)</b>	<b>33,448,842</b>

### II.B.5 Rate of Return

The current form of rate regulation practiced for the privately-owned electric utilities is a cost-based method known as the return on rate base (RORB) methodology. Power rates are set to recover cost of service prudently incurred plus a reasonable rate of return on rate base. The rate of return pertains to the percentage which when multiplied by the authorized Rate Base, provides a return that will fairly compensate the company for the risk inherent to the investment of capital. This simply means that a regulated utility is allowed to set rates which will cover operating costs and provide an opportunity to earn a reasonable rate of return on the assets utilized in the business.

On the basis of current jurisprudence, the Commission has determined that the 12% rate of return will be maintained in this case but the income tax thereon will not be allowed as operating expense. Thus, the 12% rate of return is a pre-tax rate of return which is equivalent to PhP3,948,735, computed as follows:

**Table 12**

Total Rate Base	33,448,842
Rate of Return	12%
Return on Rate Base	4,013,861

The Commission intends to adopt a new internationally accepted method of rate regulation known as Performance- Based Regulation. The treatment of income tax in this new method may be different from the present RORB method.

### II.C REVENUE REQUIREMENT SUMMARY

On the basis of the foregoing discussion, the Commission made a downward adjustment of PhP4,882,264 in IEEC's proposed revenue requirement as shown below:

**TABLE I3**

<b>REVENUE REQUIREMENT (PhP)</b>			
	<b>Per IEEC (Sch A)</b>	<b>ERC Adjustments</b>	<b>Per ERC</b>
	PhP	PhP	PhP
Purchased Power	47,833,823	(1,121,612)	46,712,211
Payroll	5,338,144	-	5,338,144
Operation & Maintenance	5,361,228	(2,799,669)	2,561,559
Depreciation and Amortization	2,936,629	-	2,936,629
Income Taxes	31,469	(31,469)	0
Other Expenses	-	-	-
Return on Rate Base	4,878,250	(864,389)	4,013,861
Revenue Requirement	66,379,543	(4,817,138)	61,562,405
Less: Other Revenue Items	-	-	-
Total Revenue Requirement	<b>66,379,543</b>	<b>(4,817,138)</b>	<b>61,562,405</b>
Existing Revenue <sup>1/</sup>			<b>60,715,946</b>
Additional Increase in Revenue			<b>846,460</b>
Additional Increase in PhP/kWh			<b>P0.0682</b>

<sup>1/</sup> see table 14

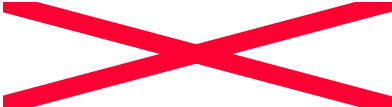
Thus, the Commission approved a total revenue requirement of PhP61,562,405 which is equivalent to an OATA increase of PhP0.0682 for IEEC.

The overall average tariff adjustment (OATA) is a measurement tool based on the formula: (Total Revenue Requirement less Existing Revenue divided by kilowatt-hour sales). This measurement is not meant to refer to any specific customer class. IEEC proposed for an OATA of PhP0.4418 per kilowatt-hour.

**II.D OPERATING REVENUE**

The Commission normalized IEEC’s existing operating revenue as follows:

**TABLE 14**


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The corresponding adjustments on IEEC's reported existing revenues were due to the following: a) increase in kWh sales (due to the annualization procedure), b) increase in power cost, and c) exclusion of 2% franchise tax.

## **II.E RATE STRUCTURE/DESIGN DETERMINATION**

### **II.E.1 Functionalization Factors**

The Commission accepts the functionalization factors used by IEEC as these are consistent with the default factors provided for in the UFR issued by the Commission on October 30, 2001.

### **II.E.2 Billing Determinants and Customer Class Allocation**

The Commission concurs with IEEC's billing determinants and allocation factors except for the billing determinant and allocation factor used for energy related costs and the data used in coincident and non-coincident peak. The Commission believes that any energy related costs should be allocated based on annualized sales.

Annualized sales were derived by multiplying year-end number of customers with average annual kWh usage for each customer class. This was performed to project for the future kWh sales for the development of a more appropriate allocation factors and billing determinants for each customer class. With the annualized sales per customer class, the computed adjusted kilowatt-hour sold was 12,412,804.

The Commission opines that in theory, the most appropriate way to allocate costs among customer classes is through cost causation principle. Thus, the Commission intends, through future proceedings to move even further towards uniform definitions of customer classes based on cost causation characteristics. However, the Commission believes that such a change would best be accomplished through the issuance of guidelines of general applicability to all utilities. Furthermore, R.A. 9136 requires identification and removal of interclass cross-subsidies.

Substantive change in customer classes at this time prevents precise calculation of cross- subsidy in existing rates. Therefore, no changes in customer class allocations are ordered for IEEC at this time.

Moreover, the Commission recomputed the customer demand component by determining the total value of the minimum size plant currently installed to get the average unit cost. The same is then multiplied by the total number of units of plant to determine the customer component. The balance thereof becomes the demand component.

## **II.F DESIGN AND CALCULATION OF CHARGES**

### **II.F.1 GENERATION CHARGE**

The Commission updated the generation cost based on the most recent approved NPC rate, *i.e.* ERC Case No. 2003-291 (In the Matter of the Application for the Approval of the Revised Unbundled Generation Tariffs, National Power Corporation (NPC) and Power Sector Assets and Liabilities Management (PSALM) – applicants) Order dated September 29, 2003.

The Commission rejects the formula proposed by IEEC for the recovery of its generation charge. The NPC's approved rate will remain fixed until changes are authorized by the Commission. This eliminates the need for future Purchased Power Adjustment (PPA) on the part of IEEC.

The Commission has developed a new recovery mechanism designed to replace the purchased power adjustment clauses being used by the power utilities. The Commission has promulgated the Implementing Guidelines on the Generation Rate Adjustment Mechanism (GRAM) effective February 24, 2003. In view, thereof, the Commission does not foresee the need for the Purchased Power Adjustment (PPA) clause. Towards this end, the Commission hereby directs IEEC to discontinue implementation of its Purchased Power Adjustment Clause (PPA) upon effectivity of the herein approved unbundled rates.

## **II.F.2 Transmission Charge**

The Commission's Decision in ERC Case No. 2001-901 dated June 26, 2002 and the Order dated September 20, 2002 set the transmission charges for the National Transmission Corporation (TRANSCO) without any provision for automatic adjustments thereof. Since the transmission rates to be paid by IEEC are fixed, it is the decision of the Commission to likewise fix the unbundled transmission rates billed to its end-users.

The transmission charge shall be billed on a fixed rate per kilowatt-hour for Residential, Commercial and Streetlights end-users. In the case of Industrial customers with demand meters, the transmission charge shall be billed using a combination of a fixed rate per kilowatt (kW) and a rate per kilowatt-hour (kWh).

The Transmission Charges approved for billing by IEEC have been calculated based on Year 2 TRANSCO rates, which was further reduced by one third (1/3) of the intra-grid subsidies. It is worth mentioning that the first year removal of Intra-grid cross subsidies was made effective on October 26, 2003.

The Commission approved the cross subsidy removal scheme for the TRANSCO in its Decision dated June 26, 2002 in ERC Case No. 2001-901 which impacts the unbundled Transmission rates for IEEC's end-users.

In consonance with the gradual phase-out of the intra-grid subsidies being billed by TRANSCO, the Commission hereby sets the transmission charges for the succeeding years, as follows:

**TABLE 15**

	<b>Residential</b>	<b>Commercial</b>	<b>Industrial</b>	<b>St. Lights</b>
October 2003 – September 2004 Demand Charge PhP/kW Transmission System Charge PhP/kWh	0.8384	0.9060	121.51 1.0728	0.7605
October 2004 – September 2005 Demand Charge PhP/kW Transmission System Charge PhP/kWh	1.0025	1.0834	145.30 1.2828	0.9094
October 2005 – September 2006 Demand Charge PhP/kW Transmission System Charge PhP/kWh	1.1472	1.2397	166.27 1.4680	1.0406

### **II.F.3 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.

A separate charge to account for allowable system loss shall likewise be provided. Hence, a distribution utility with system loss that is within the allowable cap of 9.5% for private utilities can recover from its end-users the total generation and transmission costs.

The Commission approves the recovery of allowed system loss through the establishment of a separate System Loss Charge in the bill of end-users. The System Loss Charge shall vary from customer class to another depending on their respective contributions to the system loss. However, in this particular case, IEEC’s has a uniform System Loss Charge to all type of its customers because all its customers are connected to 220kV.

The allowed systems loss is equal to the actual system loss for the test year or the existing system loss cap prescribed in R.A. 7832 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 not only results in additional unbundled generation costs but also additional unbundled transmission costs to be paid by end-users. When system loss is within the allowable cap, the distribution utility is able to recover

from the end-users all generation and transmission costs. Thus, system loss in excess of the allowable caps shall not be recovered from the end-users.

On December 8, 1994, Republic Act No. 7832, otherwise known as the Anti-Pilferage Law was enacted. In July 1995, ERB promulgated the Implementing Rules and Regulations (IRR) under ERB Case No. 95-05, to implement the said law. Section 10 of R.A. 7832 and Rule IX, Section 1 of the IRR provide that the recoverable System Loss should not exceed the 9.5% ceiling allowed for year 2000.

The Commission believes that the present cap on system loss of 9.5% should be used in the calculation of revenue requirements at this time. This would however be subject to change upon the approval of a new policy by the Commission. The actual system loss cap of 9.5% plus 1% of company use (which should not include personal consumption of IEEC's officers and employees, if applicable) or actual whichever is lower shall be deducted from total power cost and to be billed separately as System Loss Charge.

#### **II.F.4 DISTRIBUTION CHARGE**

The distribution charge shall be billed on a fixed rate per kilowatt-hour for Residential, Commercial and Streetlights end-users. In the case of Industrial customers with demand meters, the distribution charge shall be billed using a combination of a fixed rate per kilowatt (kW) and a rate per kilowatt-hour (kWh).

Relevant to distribution charge, IEEC proposed distribution wheeling rates composed of its proposed distribution and supply charges. 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 in the Rate Schedules be likewise utilized as Distribution Wheeling Charges available to the future contestable market. Other distribution utilities requesting to wheel power across IEEC'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 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. Distribution utilities are, therefore, prohibited from bundling or tying the sale of generation or purchased power with the sale of unbundled distribution wheeling service.

#### **II.F.5 METERING and SUPPLY CHARGES**

The Commission acknowledges that cost-causation rate design principles suggest 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 must also consider 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 customers. Therefore, to mitigate the impact on below-average consumption of residential end-users, the Commission orders IEEC to use a combination of PhP 5.00 per customer per month and a PhP0.3269 per kWh for the metering function and orders IEEC to use a PhP per kWh for the supply function. All other end-users shall be charged fixed monthly customer charge for metering. On the other hand, the Commission orders IEEC to use PhP16.6584 charged fixed monthly customer charge for supply function.

#### **II.G FRANCHISE TAXES**

Franchise taxes shall appear as a separate line item In the customers' bills. Given this rate design, it is appropriate to remove test year amounts associated with

franchise taxes from the revenue requirement used to calculate other recurring electricity rates.

Pending issuance of guidelines on this issue by the Department of Finance (DOF), IEEC is in the meantime directed to use the formula below in calculating franchise taxes.

Franchise Tax:

$$\text{Total Power Bill} \times FT_{x,y}$$

Where:  $FT_x$  = National franchise tax of 2%

$FT_y$  = Applicable local franchise tax

## II.H INTER-CLASS CROSS SUBSIDY

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

**TABLE 16**

### In Thousand Pesos

Customer Class	Revenue Requirement	Existing Revenue	Total Change in Revenue	Cross Subsidy (PhP)	Cross Subsidy (PhP/kWh)
Residential	39,951	36,101	3,850	(3,347)	(0.4538)
Commercial	10,573	11,959	(1,385)	1,552	0.6349
Industrial	10,731	12,332	(1,601)	1,773	0.7041
Streetlight	307	324	(17)	22	0.3279
<b>Total</b>	<b>61,562</b>	<b>60,716</b>	<b>846</b>	<b>-</b>	<b>-</b>

### II.H.1 Cross Subsidy Removal

Section 74 of R.A. 9136 and Rule 16, Section 5 of the Implementing Rules and Regulations thereof provide that ERC shall prescribe 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 extendible for a maximum period of one (1) year subject to certain conditions.

The Commission approved the cross subsidy removal scheme for the TRANSCO in its Decision dated June 26, 2002, in ERC Case No. 2001-901 which impacts the unbundled transmission rates for IEEC's end-users. This impact is reflected in the three year schedule for unbundled transmission charges provided in Section II.I above.

In the instant case, the Commission will order the cross subsidy removal process at a later date following the establishment of the Universal Charge.

## **II.I Lifeline Rate and Level**

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

In determining the lifeline level of consumption to be provided to the marginalized end-users, the Commission finds 25 kilowatt-hour as the reasonable threshold level considering that IEEC is a very small utility. Thus, the Commission sets the lifeline consumption maximum level at 50 kWh for IEEC. The Commission considers the impact that the subsidized Lifeline Rates will have on other end-users who must carry the cost 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 IEEC. The graduated scale is also based on the recognition that individual end-user consumption may likely vary from month to month.

**TABLE 17**

kWh Consumption	% Lifeline Discount
25 kWh and below	50.00
26 - 30 kWh	35.00
31 - 35 kWh	25.00
36 - 40 kWh	15.00
41 - 50 kWh	10.00

IIEC shall apply these discounts to the following residential charges: Generation, Transmission, Distribution, Supply, Metering and System Loss. In a given billing period, an end-user at any of the above-consumption level shall be given the specified corresponding discount on each of these rate components. An end-user with a level consumption exceeding 50 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 IIEC, the lifeline discounts result in a Rate Subsidy Charge by other end-users equal to PhP0.0728/kWh.

**II.J OTHER CHARGES**

IIEC's existing other charges were considered in the determination of the revenue requirement. The corresponding revenues out of these charges are appropriately deducted from the determination of the revenue requirement.

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

The compliance filing for approval of Other Charges shall include rates that are cost-based as well as supporting cost justification for the rates, including but not

limited to the amount to the amount of actual time and wages of employees performing each task encompassed by each type of Other Charges.

**II.K 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 100 kWh a month using rates based on IEEC's actual existing rates as of October 2003 against the unbundled rates approved by the Commission is shown below:

**TABLE 18**

<b>RESIDENTIAL 100 kwh</b>					
<b>Based on Actual EXISTING RATES</b>			<b>Based on ERC APPROVED UNBUNDLED RATES</b>		
	PhP/kWh	Amount		PhP/kWh	Amount
Basic Charge:			Generation Charge	2.4962	249.62
1st 16 kWh	2.67	42.72	Transmission Charge	0.8384	83.84
Next 14 kWh	2.70	37.80	System Loss Charge	0.3681	36.81
Next 20 kWh	2.72	54.40	Distribution Charge	1.1439	114.39
Next 50 kWh	2.75	137.50	Supply Charge		16.6584
Over 100 kWh	2.77		Metering Charge		
sub-total		272.42	Retail Customer Charge/Mo.		5.00
			Metering System Charge	0.3269	32.69
Power Act Reduction	(0.3000)	(30.00)	Inter-Class Cross Subsidy Charge	(0.4535)	(45.35)
			Subsidy on Lifeline	0.0728	7.28
PPA	2.4531	245.31	Power Act Reduction	(0.30)	(30.00)
Universal Charge					470.93
Missionary	0.0373	3.73	Discount on Lifeline Customer	0%	0.00
Environmental	0.0025	0.25	SUB-TOTAL		470.93
			Franchise Tax	0.0200	9.42
			Universal Charge		
			Missionary	0.0373	3.73
			Environmental	0.0025	0.25
<b>TOTAL BILL</b>		<b>491.71</b>			<b>484.34</b>
<b>Peso/kWh</b>		<b>4.92</b>			<b>4.84</b>
			<b>Inc./(Dec.) In Bill</b>		<b>(7.37)</b>
			<b>Inc./(Dec.) In Rates</b>		<b>(0.08)</b>

Note: Basic Charge inclusive of Franchise Tax

Pending guidelines to be issued by DOF, Franchise tax was computed based on the total bill except UC.

## **II.L ERC CASE NO. 2001-20**

For further consideration of the Commission is ERB Case No. 2001-20 where the previous Board provisionally authorized IEEC an across-the-board rate increase of P0.34/kwh in the ERB Order dated August 13, 2001. The Commission decided that said case be declared moot and academic for the reason that the unbundling case already addresses the same concern inasmuch as test year period used is the same.

### **DISPOSITION**

**WHEREFORE**, the foregoing premises considered, this Commission hereby decides as follows:

1.) To approve the unbundled schedule of rates of IEEC, as provided below of this Decision, to be effective on the next billing cycle after the date of this Order;

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**IBAAN ELECTRIC AND ENGINEERING CORPORATION (IEEC)  
ERC CASE NO. 2001-951  
RATE SCHEDULE**

Customer Class	Gen. Charge	Transmission Charge		Distribution Charge		Supply Charge	Metering Charge		System	Recovery of Lifeline Rate Subsidy	Lifeline Discount (%)	Inter-class Cross Subsidy Year 1	Universal Charge	
		P/kWh	P/kW	P/kWh	P/kW		P/cust/mo.	P/kwh	P/meter/mo.				Loss Charge	P/kWh
<b>RESIDENTIAL</b>														
0 - 25	2.4962	0.8384		1.1439		16.6584	0.3269	5.00	0.3681	-	50%	(0.4535)	0.0373	0.0025
26 - 30	2.4962	0.8384		1.1439		16.6584	0.3269	5.00	0.3681	-	35%	(0.4535)	0.0373	0.0025
31 - 35	2.4962	0.8384		1.1439		16.6584	0.3269	5.00	0.3681	-	25%	(0.4535)	0.0373	0.0025
36 - 40	2.4962	0.8384		1.1439		16.6584	0.3269	5.00	0.3681	-	15%	(0.4535)	0.0373	0.0025
41 - 50	2.4962	0.8384		1.1439		16.6584	0.3269	5.00	0.3681	-	10%	(0.4535)	0.0373	0.0025
Over 50 kWh	2.4962	0.8384		1.1439		16.6584	0.3269	5.00	0.3681	0.0728		(0.4535)	0.0373	0.0025
<b>COMMERCIAL</b>	2.4962	0.9060		0.4369		16.6584		34.81	0.3681	0.0728		0.6349	0.0373	0.0025
<b>INDUSTRIAL</b>	2.4962	0.5364	121.51	0.2281	14.10	16.6584		523.01	0.3681	0.0728		0.7031	0.0373	0.0025
<b>ST. LIGHT</b>	2.4962	0.7605		0.7439		16.6584		34.81	0.3681	0.0728		0.3287	0.0373	0.0025

Note: Plus National & Local Franchise Tax

2.) To direct IEEC to comply with the following:

- a) To 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 in accordance with a recovery mechanism to be prescribed by the Commission;
- b) Make a compliance filing with respect to Other Charges a year from date of this Decision;
- c) To bill the amount of P0.0373/kWh representing the missionary electrification portion of the Universal Charge in accordance with the Decision of the Commission in ERC Case No. 2001-165 (In the

Matter of the Petition for the Availments from the Universal Charge the Share for Missionary Electrification, NPC-SPUG, Applicant);

- d) Bill the amount of P0.0025/kWh representing the environmental portion of the Universal Charge in accordance with the Commission's Decision 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, Applicant);
- e) To set up a depreciation fund each year corresponding the whole amount of depreciation that it has recorded in its books. The setting up of this fund should be done on a monthly basis corresponding to the monthly depreciation. IEEC is required to strictly account for the expenditures out of this fund which should be used strictly for investment in electric plant and all withdrawals from this fund should be reported to the Commission within thirty (30) days from the withdrawal;
- f.) To inform the end-users within its franchise area of the approved unbundled rates not later than thirty (30) days after receipt of this Decision;
- g.) To bill its respective end-users using a billing format which contains at least the rate elements provided in "Annex A" (Rate Schedule) of this Decision upon effectivity of the approved unbundled rates;
- h.) To inform the end-users within its franchise area of the approved unbundled rates not later than thirty (30) days after receipt of this Decision;
- i.) To bill its respective end-users using a billing format which contains

at least the rate elements provided in “Annex B” of this Decision upon effectivity of the approved unbundled rates. The rate elements provided in “Annex B” should appear on the end-users’ bills even if the rate elements currently have a rate of zero (0) or have not yet been determined by the Commission; and

- j.) To submit for verification and confirmation purposes on or before the twentieth (20<sup>th</sup>) day of the month following the effectivity of the approved unbundled rates and every month thereafter; a) five (5) sample bills for each customer class; (b) a copy of bills from the generation and transmission companies; and (c) M001 and M002 with all related schedules;

SO ORDERED.

Pasig City, January 9, 2003.

**MANUEL R. SANCHEZ**  
Chairman

**JESUS N. ALCORDO**  
Commissioner

**LETICIA V. IBAY**  
Commissioner

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