

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 NOS. 2001-916
and 2002-020**

**ILOCOS NORTE ELECTRIC COOPERATIVE,
INC. (INEC),**

Applicant.

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DECISION

Before this Commission for resolution is the application filed on December 26, 2001 by Ilocos Norte Electric Cooperative, Inc. (INEC) for the approval of its unbundled rates pursuant to the provision of Republic Act No. 9136 (R.A. 9136).

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 15, 2002 were issued setting the same for hearing on May 27, 2002.

INEC 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, INEC had the Notice of Public Hearing published in *Malaya* on May 4 and May 11, 2002 and *Liwayway Publishing Inc.* on May 5 and May 12, 2002.

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

Likewise, the City/Municipal Mayors of Adams, Bacarra, Badoc, Bangui, Banna, Batac, Burgos, Carasi, Currimao, Dingras, Dumalneg, Laoag City, Marcos, Nueva Era, Pagudpud, Paoay, Pasuquin, Piddig, Pinili, San Nicolas, Sarrat, Solsona and Vintar, all in the Province of Ilocos Norte were furnished with copies of the Order and the Notice of Public Hearing for the appropriate posting thereof on their respective bulletin boards.

At the initial hearing on May 27, 2002, the counsel for INEC appeared and entered his appearance. Engr. Robert Mallilin and Mr. Amado Pacpaco also appeared and registered their appearances as intervenors.

During the said hearing, INEC presented proofs of compliance with the Commission's publication and posting of notice requirements, which were duly marked as Exhibits "A" to "C-22", inclusive. Thereafter, INEC presented its witness, Ms. Rosita A. Bumanglag, INEC's Finance Manager, who testified on the documents submitted in support of the application as well as on certain relevant schedules. In the course of her testimony, several documents were presented, identified by reference and marked as Exhibits "D" to "NN", inclusive.

During the May 28, 2002 hearing, the second witness, Engr. Renato A. Ballente, INEC's Engineering Manager, testified on the various technical aspects of the application. The Commission and the intervenors propounded clarificatory questions on the two (2) witnesses. In the course thereof, INEC was directed to submit a) Revised Computation of the Uniform Rate Filing Requirement (UFR); and b) breakdown of the past five years expenses within fifteen (15) days from said date of hearing.

At the July 9, 2002 hearing, INEC was directed to submit a) proposal on the subsidy of lifeline rates; and b) explanation on system loss reduction target.

INEC then moved that it be given ten (10) days from the said date of hearing within which to submit all the required documents. Said motion was granted. In compliance therewith, INEC submitted said documents on various dates.

On August 9, 2002, INEC submitted its "Formal Offer of Evidence" which was admitted by the Commission, for the purposes for which they were offered.

I. SUMMARY OF INEC'S APPLICATION

I.A. REVENUE REQUIREMENT

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

Account Name	HISTORICAL YEAR	
kWh Sales		110,030,114
Purchased Power	PhP	406,990,676
Payroll		51,932,223
Operation and Maintenance (less Purchased Power & Payroll)		74,223,913
Other Expenses		0
Debt Service (plus interest cost of cash working capital)		44,372,869
Revenue Requirement	PhP	577,519,681
Less: Other Revenue Items		0
Reinvestment Fund (13%) ¹		72,761,473
TOTAL REVENUE REQUIREMENT	PhP	650,281,154

INEC's proposed revenue requirement was PhP 650,281,154, based on historical costs for the year 2000. The Overall Average Tariff Adjustment (OATA) published was PhP 0.9591/kWh.

INEC 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/DESIGN²

The unbundled rates proposed by INEC were as follows:

Residential / BAPA

Distribution Charge	PhP	2.2677/kWh
Generation Charge		3.6989/kWh
Supply Charges		
Retail Customer Charge		14.77/customer/month
Metering Charge		10.23/customer/month

Small Commercial

Distribution Charge		1.4903/kWh
Generation Charge		3.6989/kWh
Supply Charges		
Retail Customer Charge		26.22/customer/month
Metering Charge		23.78/customer/month

Large Commercial

Distribution Charge		0.7087/kWh
Demand Charge		92.37/kW
Generation Charge		3.6989/kWh
Supply Charges		
Retail Customer Charge		26.73/customer/month
Metering Charge		73.27/customer/month

Irrigation

Distribution Charge		0.9966/kWh
Generation Charge		3.6989/kWh
Supply Charges		
Retail Customer Charge		20.35/customer/month
Metering Charge		79.65/customer/month

Industrial

Distribution Charge		0.8187/kWh
Demand Charge		72.93/kW
Generation Charge		3.6989/kWh
Supply Charges		
Retail Customer Charge		64.78/customer/month
Metering Charge		435.22 /customer/month

² Based on INEC's "Post Hearing Compliance dated July 25, 2002."

Public Buildings

Distribution Charge	PhP	1.9801/kWh
Generation Charge		3.6989/kWh
Retail Customer Charge		22.71/customer/month
Metering Charge		27.29/customer/month

Street Lights

Distribution Facilities Charge		0.2189/customer/month
Distribution Charge		2.1516/kWh
Generation Charge		3.6989/kWh

I.B.1. FUNCTIONALIZATION, CLASSIFICATION and ALLOCATION

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

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

I.B.2. SYSTEM LOSS

Witness Ballente, in his testimony, stated that INEC's system loss in the year 2000 was 13.76% [May 28, 2002, Transcript of Stenographic Notes (TSN), page 17]. His assumption was that out of the 13.76% system loss, 1% was non-technical loss brought about by right of way clearing and pilferage (May 28, 2002, TSN, page 22). Furthermore, Witness Ballente testified that the usual

kinds of pilferage are meter tampering and use of jumpers (May 28, 2002, TSN, page 23).

I.B.3. INTER-CLASS CROSS SUBSIDY

INEC 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/BAPA	402,187,203	437,749,427	(35,562,224)
Small Commercial	33,249,246	29,756,843	3,492,403
Large Commercial	113,993,288	89,728,368	24,264,920
Irrigation	9,851,920	7,793,540	2,058,380
Industrial	31,656,657	26,260,084	5,396,573
Public Buildings	51,359,121	50,029,219	1,329,901
Street Lights	7,983,719	8,963,672	(979,953)
Total	650,281,154	650,281,154	0.00

I.B.4. LIFELINE RATE and LEVEL

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

	Option 1 (At Proposed Generation and Distribution Charges Only)
Level	10 kWh
Rate	PhP 5.9666/kWh

I.C. OTHER CHARGES

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

PARTICULARS	RATES
1. Membership Fee	PhP 5.00
2. Guaranty Payment	
Service Drop (per meter)	17.60
KWh Meters	
GE (F 72)	1,000.00
Harbin	600.00
Fujidharma (Square)	972.00
GE CL 100	1,875.00
Fuji (10/30A)	950.00
3. Inspection Fee	10.00
4. Others:	
Relocation/Change Meter	150.00
Tapping Accessories	173.00
Interest (2.5%) and Collection Fee	1.00
Reconnection Fees:	
Delinquency	150.00
Pilferage	2,500.00
Service Charges:	
Special Lighting	150.00

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, intervenors and other interested parties who manifested their respective positions on this present application.

II.A.1. TEST YEAR

The Commission finds INEC'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. Therefore, the discussions and conclusions that follow are based on Schedule A, adjusted to audited financial statement figures for the historical test year 2000.

II.A.2. GENERATION and TRANSMISSION COSTS

At present, INEC buys approximately 98% of its power requirements from NPC and the balance from its own generation.

The Generation and Transmission charges shall reflect the power supplier's generation charges and transmission charges of the National Transmission Corporation (TRANSCO) as approved in ERC Orders dated September 6 and 20, 2002, 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) and the average cost of power from its own generation. The FOREX Component of the NPC's Generation Rate used pertains to the supply month of May 2003 amounting to PhP 0.2506 per kWh. A separate charge to account for the allowable system loss shall likewise be provided in the bill to end-users (please refer to Section II.B.2.d for details). Hence, a distribution utility with a system loss that is within the allowable cap

can recover from its end-users the total cost of generation and transmission. *Annualization*³ of billing determinants was applied.

The upward adjustment made by the Commission to Purchased Power of PhP 2,314,363 consisted of the following:

Particulars	Amount (PhP)
Adjustment to Purchased Power Cost	2,408,608
Less: Adjustment to System Loss (particularly the excess in utility's use of power for its own operations)	94,245
Total Adjustments	2,314,363

The adjustment to Purchased Power Cost of PhP 2,408,608 pertains to the difference between the proposed Purchased Power of INEC amounting to PhP 406,990,676 and the Purchased Power cost based on the new rates of NPC and TRANSCO plus the average cost of electric power from INEC's own generation amounting to PhP 409,399,284.

Records show that INEC's actual use of power for its own operations for the year 2000 was 1.02%. The Commission allowed a utility's use of power for its own operations of 1% in the calculation of INEC's revenue requirement as discussed in Section II.B.2.d. Thus, the Commission made an adjustment to system loss (the utility's use of power for its own use being a component of the system loss) of PhP 94,245 to exclude the excess of actual utility's use of power for its own operations over the allowable recoverable cap of PhP 53,700,821.

³ The annualization of kWh sales is calculated by multiplying the average kWh consumption of a specific customer class by their respective year-end number of customers.

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

Particulars	Amount (PhP)
Generation Charge	275,431,020
Transmission Charge	80,173,198
Recoverable System Loss	53,700,821
TOTAL	409,305,039

INEC's approved generation charge shall remain fixed and any change thereon, shall be reflected as deferred charges or credits which shall be recovered through GRAM and ICERA pursuant to the Commission's Order dated February 24, 2003, Case No. 2003-44 [In the Matter of the Adoption of the Generation Rate Adjustment Mechanism (GRAM) and Incremental Currency Exchange Recovery Adjustment (ICERA)]. In the meantime, INEC shall discontinue charging the Purchased Power Adjustment (PPA) upon effectivity of the unbundled rates.

II.A.3. PAYROLL

The Commission made a downward adjustment in INEC's payroll by PhP 649,340 representing the unaccounted portion of its payroll account.

Particulars	Amount (PhP)
Payroll Account (per UFR)	51,932,223
Less: Unaccounted portion of the payroll account	649,340
ADJUSTED PAYROLL	51,282,883

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 INEC 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 the R.A. 9136 to establish a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency, enjoins INEC 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.

INEC'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 INEC's viability. To this end, INEC should view a petition for an increase in rates to be the last recourse. In future filings, INEC 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 disallowed expenses of PhP 12,371,723, which consist of incentive pay above NEA guidelines, meals, lodging, honorarium, group insurance, cell card allowance, executive check-up, financial assistance, wreaths, appliances for Christmas raffle, advertisements, foods and drinks during Christmas party and other miscellaneous expenses which were found to have gone beyond the necessity by which these expenses were meant for. In addition, the year 2001 expenses were excluded because said amount does not belong to the test year 2000 and therefore should not be considered in the calculation of revenue requirement. Further, the Commission limits the expenses pertaining to the contribution required to provide employees' past service to an amount equivalent to one month's basic salary of INEC's employees; the excess amount was disallowed as a recoverable expense.

The disallowed expenses were excluded for revenue requirement determination. These expenses translate to PhP 0.1104/kWh which the Commission considers material.

For future rate cases, INEC will continually 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. INEC 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 as revenues earned (net of other expenses) by the electric utilities from activities other than sale of electricity.

The Commission encourages INEC to improve its financial condition through the development of other related sources of revenue. However, in order to balance the interests of INEC and its end-users and in recognition of the fact that some of the costs incurred in providing certain services classified under ORI had already been included in the revenue requirement, the Commission is reducing total revenue requirement by 50% of the total net ORI. This reduction of 50% amounts to PhP 8,290,266 computed as shown below:

Net Other Revenues	Amount (PhP)
PPD availed from NPC	11,781,230
Less: PPD given to consumers	<u>2,102,100</u>
Net Prompt Payment Discount	9,679,130
Surcharges and Collection Fees	1,734,935
Rent from Electric Property:	
Pole Rental	1,261,365
Transformer Rental	98,197
Reconnection Fees	245,245
Penalties – Pilferage	185,342
Gain on Sale of Scrap Materials	13,010
Special Lighting	3,048,017
Inspection Fees	246,577
Others	68,714
Total Other Revenues	16,580,532
50% of Total Other Revenues	8,290,266

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

II.A.6. DEBT SERVICE

INEC's debt service account reflected an amount of PhP 44,372,869 consisting of actual payments of its loans to NEA in the amount of PhP 22,000,000; interest cost of Cash Working Capital amounting to PhP 13,087,646; ERBP Loan Amortization in the amount of PhP 2,400,000 and Employees Past Service amounting to PhP 6,885,223. However, INEC did not provide the Commission details of its debt service account.

The Commission made a downward adjustment of PhP 26,457,521 to assure that the debt service account included in INEC's revenue requirement is consistent with NEA's records. The details of the adjustments are shown below.

Particulars	Amount (PhP)
Adjustments:	
Decrease in the amount of debt service to reconcile INEC's proposed debt service with that of NEA's records	4,084,652
Add: Disallowances	
Interest Cost on Cash Working Capital (CWC)	13,087,646
ERBP Loan Amortization	2,400,000
Employees Past Service	6,885,223
Total Downward Adjustment to the Debt Service Account	26,457,521

The Commission disallowed the interest cost associated with cash working capital as calculated by INEC, due to lack of justification; ERBP Loan Amortization (representing an amount loaned from Employees Retirement Benefits Plan used to purchase INEC's substation lot) as INEC is already provided a provision for reinvestment fund where INEC can source the amortization, and Employees Past Service under the debt service account but allowed a provision for this which is equivalent to one (1) month basic salary of INEC's employees under the O & M expense account. However, the excess amount was disallowed as a recoverable expense. Thus, the total allowable amount for debt service in the determination of revenue requirement should only be PhP 17,915,348. The details are shown below:

LOANS	PER NEA (PhP)
Rural Electrification:	
LOAN A	1,054,009
LOAN B	889,009
LOAN C1	122,930
LOAN C2	948,972
LOAN D	1,561,528
LOAN E	2,783,860
LOAN F	2,353,800
LOAN G	3,601,540
Sub-Total	13,315,648
EL – Concessional	
T-ILIANG	540,904
Short Term:	
STL-Insurance	102,848
WBANK-RERP (RE)	2,767,372
WBANK-RERP (LOG)	2,983,604
COMPAC I USA	1,291,424
Sub-Total	7,686,152
TOTAL ANNUAL DEBT SERVICE	21,001,800
Less: Loan already paid in 2001	
STL – Insurance	102,848
WBank- RERP (LOG)	2,983,604
Net Annual Debt Service	17,915,348

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 the EC's end-users. The cooperative 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 21, 2003, granted INEC a Provisional Authority to reduce its rates by PhP 0.0739/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

INEC made a proposal for a provision for reinvestment fund in its unbundling of rates application in the amount of PhP 72,761,473.

The Commission permits a reinvestment fund of PhP 28,003,431 equivalent to 5% of a cooperative'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 a downward adjustment of the difference of PhP 44,758,042 in the reinvestment fund account.

One of the main purposes of providing the 5% Reinvestment Fund is for the end-users of INEC 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 INEC;

- c) INEC 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 INEC to appear and show cause why it should continue collection of the reinvestment fund; and

- d) INEC 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 a comparison of the approved revenue requirement with that proposed by INEC:

	INEC Proposal (PhP)	Adjustments (PhP)	ERC Approval (PhP)
Purchased Power	406,990,676	2,314,363	409,305,039
Payroll	51,932,223	(649,340)	51,282,883
O & M (less PP & Payroll)	74,223,913	(12,371,723)	61,852,190
Debt Service (including Interest Cost on CWC)	44,372,869	(26,457,521)	17,915,348
Reinvestment Fund ⁴	72,761,473	(44,758,042)	28,003,431
Other Revenue Items	0	(8,290,266)	(8,290,266)
Total Rev. Requirement	650,281,154	(90,212,529)	560,068,625

INEC proposed an OATA of PhP 0.9591/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 90,212,529 approves a total revenue requirement of PhP 560,068,625, equivalent to an OATA⁵ of PhP 0.0522/kWh for INEC. The actual impact to end-users will depend on the level of rates currently being charged. This impact is illustrated in Section II.B.6 of this Decision.

⁴ In the UFR, this item is reflected as "Plus Percentage for Cooperative Investment".

⁵ The OATA was computed using existing approved distribution rates (inclusive of current WAC, if any) and unbundled power cost as of May 2003.

II.B. RATE STRUCTURE/DESIGN DETERMINATION

II.B.1 FUNCTIONALIZATION, CLASSIFICATION and ALLOCATION

The functionalization and allocation factors used by INEC were the default factors provided for in the UFR issued by the Commission on October 30, 2001. In the case of INEC, 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 INEC 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 the factor “Total Payroll Excluding Administrative and General Payroll” (PAYXAG) in order to remove the possibility of allocating a portion of outside services costs to transmission function.

Third, since the Commission is now including Other Revenue Items (ORI), 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	0.2724	0.6738	0.0538

INEC submitted allocation of distribution costs into demand and customer – related cost using the *Minimum Plant Method*. This method resulted in a 40% - 60% 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 is 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, 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. 2001-901, In the Matter of the Application for Approval of the Revised Unbundled Power Rates, National Power Corporation – Applicant, dated June 26, 2002 and the Commission's Orders dated September 6 and 20, 2002, the generation charge to be billed to end-users shall be the approved rate per kilowatt-hour including Benefits to Host Communities and Franchise Charge and Foreign Exchange Rate Adjustment (FOREX) and the average cost of power from its own

generation. The FOREX component of the NPC's Generation rate used pertains to the supply month of May 2003 amounting to PhP 0.2506 per kWh. This allows INEC's generation charge to remain fixed and any changes thereon, shall be reflected as deferred charges or credits which shall be recovered through GRAM and ICERA pursuant to the Commission's Order dated February 24, 2003, as discussed in Section II.A.2 of this Decision.

In the meantime, INEC shall discontinue charging the Purchased Power Adjustment (PPA) upon the effectivity of the unbundled rates.

II.B.2.c. TRANSMISSION CHARGE

The Commission's Decision in ERC Case No. 2001-901 dated June 26, 2002 and Order dated September 20, 2002 set the transmission charges for the TRANSCO without automatic adjustments. Since the transmission rates to be paid by INEC 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 INEC have been calculated based on the approved TRANSCO rates which include cross subsidy elements to be phased out over the three-year period.

Transmission Charges	Residential	Small Commercial	Large Commercial	Industrial	Irrigation	Public Bldgs.	Street Lights
YEAR 1							
Demand Charge PhP/kW			19.36	19.36			
Transmission System Charge PhP/kWh	0.3677	0.9283	0.8965	1.3943	0.6036	2.2236	1.4703
YEAR 2							
Demand Charge PhP/kW			19.36	19.36			
Transmission System Charge PhP/kWh	0.4481	1.1314	1.1105	1.7222	0.7356	2.7100	1.7919
YEAR 3							
Demand Charge PhP/kW			19.36	19.36			
Transmission System Charge PhP/kWh	0.5286	1.3345	1.3247	2.0503	0.8677	3.1965	2.1136
YEAR 4							
Demand Charge PhP/kW			19.36	19.36			
Transmission System Charge PhP/kWh	0.6090	1.5375	1.5388	2.3782	0.9997	3.6829	2.4352

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 INEC.

The allowed system loss is equal to the average actual 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 risks 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 shall 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 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 the 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 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 Technical and Non-Technical Loss or cap of 14% plus 1% cooperative own use (which should not include the personal consumption of INEC'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.

Records show that INEC's actual system loss in the test year 2000 was 12.74%. The Commission however recognizes that INEC's current system loss level has already changed and therefore, may not reflect the fair System Loss Charge that will be provided to INEC. Hence, the Commission considered the 2000 to 2002 average system loss of 12.12% as a reasonable compromise to balance the interests of both INEC and its end-users.

II.B.2.e. DISTRIBUTION CHARGE

The distribution charge shall be billed on a fixed rate per kilowatt-hour for all end-users. For Large Commercial and Industrial end-users, the distribution charge shall be billed using a combination of a fixed rate per kilowatt (kW) and a fixed rate per kilowatt-hour (kWh).

INEC did not propose 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. Other distribution utilities requesting to wheel power across INEC's facilities shall pay wheeling charges equivalent to Distribution Wheeling Charges for Industrial end-users.

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 generated 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 (including those connected to BAPAs), the Commission orders INEC to use a combination of a PhP 5.00 per meter per month and a PhP 0.2894 per kWh rate for the metering function. On the other hand, the Commission orders INEC to use a PhP per kWh rate for the supply function. All other end-users shall be billed on a fixed monthly customer charge for both metering and supply functions.

All BAPA residential end-users will be charged with rates used for the Residential Class. INEC will draw the various incentives it will provide the BAPA from the revenues that will be generated from the Supply and Metering Charges from BAPA end-users.

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	Small Commercial	Large Commercial	Industrial	Irrigation	Public Bldgs.	Street Lights
New Cost-Based Rev. Req. PhP	560,068,625	349,361,984	27,864,403	82,493,611	26,751,380	7,104,445	57,385,580	9,107,222
Existing Rates Revenue PhP	554,223,337	347,601,641	28,823,414	91,999,955	25,779,856	9,017,628	43,747,849	7,252,994
Total Change in Revenue PhP	5,845,288	1,760,343	(959,011)	(9,506,344)	971,524	(1,913,183)	13,637,731	1,854,228
Percentage Change in Revenue PhP	1.05%							
Normalized Existing Revenue PhP	560,068,625	351,267,729	29,127,409	92,970,261	26,051,751	9,112,735	44,209,249	7,329,491
Inter-Class Cross - Subsidy Amounts PhP	0	1,905,746	1,263,006	10,476,650	(699,630)	2,008,290	(13,176,330)	(1,777,732)
Class Billing Determinants kWh	112,018,472	70,256,523	5,825,729	18,594,840	5,210,571	1,822,624	8,842,225	1,465,960
Inter-Class Cross Subsidy Rates PhP / kWh		0.0271	0.2168	0.5634	(0.1343)	1.1019	(1.4902)	(1.2127)

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.

The Commission approved the cross subsidy removal scheme for TRANSCO in its Decision dated June 26, 2002, Case No. 2001-901, which impacts the unbundled transmission rates for INEC's end-users. This impact is reflected in the three-year schedule for unbundled transmission charges provided in Section II.B.2.c 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. Until such time, INEC 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 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 its corresponding discount rates.

In determining the minimum 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 the level of the lifeline 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 20 kWh for INEC. The Commission considers the impact 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 INEC. The graduated scale is also based on the recognition that individual end-user consumption may likely vary from month to month.

15 kWh and below	-	50%
16 kWh	-	40%
17 kWh	-	30%
18 kWh	-	20%
19 kWh	-	10%
20 kWh	-	5%

INEC 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 levels shall be given the specified corresponding discount on each of these rate components. An end-user with a level of consumption exceeding 20 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 INEC, the lifeline discounts result in a Lifeline Rate Subsidy by other end-users equal to PhP 0.0732/kWh.

The Commission believes that BAPA's marginalized residential end-users should likewise enjoy the benefit of lifeline rates. For this purpose, the Commission accepts INEC's proposal to integrate the household connections of BAPA into the Residential customer class.

INEC shall coordinate with its Barangay Power Associations to gather information on the number of kWh falling under the different lifeline levels and corresponding discount rates for proper billing and implementation of lifeline benefits on the same. Each association will accordingly implement/provide lifeline benefits to its deserving BAPA end-users.

II.B.5. OTHER CHARGES

INEC's additional submission to this Commission of its existing Other Charges as previously presented was considered in the determination of its revenue requirement. Fifty percent (50%) of the revenues derived from these charges were appropriately deducted from the determination of the revenue requirement allowed to INEC. In future cases filed after Other Charges have been established based on cost, the appropriate level of deduction of the revenue derived from these charges maybe revisited.

The Other Charges of INEC are hereby pegged at their existing levels until such time that the Commission sets new rates on the same. Further, INEC is ordered to make a compliance filing on its Other Charges one (1) 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 justifications 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 to the revenue requirement on the monthly bill of an average residential end-user consuming 79 kWh a month using rates based on INEC's actual existing rates as of May 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	3.4249	270.57	Generation Charges:		
PPA	1.5238	120.38	Generation System Charge	2.1892	173.11
WAC	0.0859	6.79	Benefits to Host Communities Charge	0.0240	1.94
PAR	(0.3000)	(23.70)	FOREX	0.2456	19.80
Missionary			Transmission System Charge	0.3677	29.05
Electrification	0.0168	1.33	System Loss Charge	0.4794	37.96
Environmental			Distribution Charge	0.8477	67.00
Share	0.0025	0.20	Supply Charge	0.4866	38.44
Rate Reduction			Metering Charges:		
Due to Loan			Retail Customer / Month		5.00
Condonation	(0.0739)	(5.84)	Metering System Charge	0.2894	22.87
			Inter-Class Cross Subsidy Charge	0.0271	2.14
			Universal Charge:		
			Missionary Electrification Charge	0.0168	1.33
			Environmental Share	0.0025	0.20
			Lifeline Rate[(Discount)/Subsidy]	0.0732	5.79
			Power Act Rate Reduction	(0.3000)	(23.70)
			Rate Reduction due to Loan Condonation	(0.0739)	(5.84)
TOTAL BILL		369.73	TOTAL BILL		374.35
PhP/kWh		4.6801	PhP/kWh		4.7386

DISPOSITION

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

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

Decision, to wit:

	Residential	Small Commercial	Large Commercial	Industrial	Irrigation	Public Buildings	Street Lights
Generation Charges:							
Generation System Charge (PhP/kWh)	2.1892	2.1892	2.1892	2.1892	2.1892	2.1892	2.1892
Franchise & Benefits to Host Communities Charge (PhP/kWh)	0.0240	0.0240	0.0240	0.0240	0.0240	0.0240	0.0240
FOREX Adjustment Charge (PhP/kWh)	0.2456	0.2456	0.2456	0.2456	0.2456	0.2456	0.2456
Transmission Charges:							
Demand Charge (PhP/kW)			19.36	19.36			
Transmission System Charge (PhP/kWh)	0.3677	0.9283	0.8965	1.3943	0.6036	2.2236	1.4703
Distribution Charges:							
Demand Charge (PhP/kW)			19.36	19.36			
Distribution System Charge (PhP/kWh)	0.8477	0.6180	0.3704	0.5508	0.3004	1.1748	1.6930
System Loss Charge (PhP/kWh)	0.4794	0.4794	0.4794	0.4794	0.4794	0.4794	0.4794
Supply Charges:							
Retail Customer Charge (PhP/Customer/ Month)		33.06	33.076	84.80	33.06	32.35	33.06
Supply System Charge (PhP/kWh)	0.4866						
Metering Charges:							
Retail Customer Charge (PhP/Meter/ Month)	5.00	29.44	79.75	592.89	168.70	27.88	22.96
Metering System Charge (PhP/kWh)	0.2894						
Inter-Class Cross Subsidy Charge (PhP/kWh)	0.0271	0.2168	0.5634	(0.1343)	1.1019	(1.4902)	(1.2127)
Universal Charge: (PhP/kWh)							
Missionary Electrification Charge	0.0168	0.0168	0.0168	0.0168	0.0168	0.0168	0.0168
Environmental Share	0.0025	0.0025	0.0025	0.0025	0.0025	0.0025	0.0025
Lifeline Rate (Discount)/Subsidy (PhP/kWh)	0.0732	0.0732	0.0732	0.0732	0.0732	0.0732	0.0732
Power Act Reduction (PhP/kWh)	(0.3000)						
Rate Reduction due to Condonation of Loan (PhP/kWh)	(0.0739)	(0.0739)	(0.0739)	(0.0739)	(0.0739)	(0.0739)	(0.0739)

Lifeline Rate (Discount)/Subsidy To be based on residential rate in a graduated scale as provided in Section II.B.4 of this Decision.

Rate Reduction due to Loan Condonation effective April 2003 as per ERC Order dated March 21, 2003.

2. To direct INEC 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 and ICERA;
 - b) Discontinue the application of the Wage Adjustment Clause (WAC) formula upon effectivity of the approved unbundled rates;
 - c) Bill PhP 0.0168/kWh representing the missionary electrification portion of the Universal Charge in accordance with the Order of the Commission in ERC Case No. 2001-165 (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, 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-users 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 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, 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, June 25, 2003.

MANUEL R. SANCHEZ
Chairman

OLIVER B. BUTALID
Commissioner

MARY ANNE B. COLAYCO
Commissioner

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Commissioner

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