

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

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

ERC CASE NO. 2001-998

QUEZON II ELECTRIC COOPERATIVE,
INC. (QUEZELCO II),

Applicant.

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DECISION

Before this Commission for resolution is the application filed on December 26, 2001 by applicant Quezon II Electric Cooperative, Inc. (QUEZELCO II) for approval of its unbundled rates pursuant to the provisions of Republic Act No. 9136 (RA 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 January 2, 2003, were issued setting the case for initial hearing on February 24, 2003.

QUEZELCO II 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.

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 Mayors of the Municipalities of Burdeos, General Nakar, Infanta, Jomalig, Patnanungan, Panukalan, Polilio and Real, all in the Province of Quezon, 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 November 19, 2002, QUEZELCO II appeared and manifested that there were errors in the data submitted. Thus, it moved that it be allowed to correct its submissions, within fifteen (15) days from said date of hearing. Said motion was granted.

On December 11, 2002, QUEZELCO II submitted a "Second Revised Compliance" proposing to revise its Overall Average Tariff Adjustment (OATA) as a result of the revision of documents submitted in support of its application in accordance with the prescribed Uniform Rate Filing Requirements (UFR).

On January 2, 2003, the Commission issued an Order directing QUEZELCO II to re-publish the Notice of Public Hearing indicating therein the new date of initial hearing which was set on February 24, 2003. In compliance with the said directive, QUEZELCO II published the Notice of Public Hearing in the "*The Manila Times*" and "*Kabayan*" both on January 20 and 27, 2003.

At the re-scheduled initial hearing on February 24, 2003, only QUEZELCO II was present. No oppositor appeared nor was there any opposition registered.

During said hearing, QUEZELCO II submitted proofs of its compliance with the Commission's publication and posting of notice requirements which were duly marked as Exhibits "A" to "C-7", inclusive. Thereafter, QUEZELCO II presented its two (2) witnesses. The first witness, Ms. Aidalyn S. Virrey, QUEZELCO II's Finance Manager, testified on certain relevant schedules and on the documents submitted in support of the application. At the termination of the direct examination, the Commission propounded clarificatory questions on the same witness.

The second witness, Engr. Von Ervin G. Azagra, QUEZELCO's Technical Services Manager, testified on the various technical aspects of the application including its proposed program for the development and improvement of its services. At the termination of the direct examination, the Commission again propounded clarificatory questions on the same witness.

In the same hearing, QUEZELCO II was directed in open court to submit various documents.

On March 17, 2003, the Commission received a letter from Mr. Severino P. Coronacion, Acting OIC of the Sangguniang Bayan of Infanta, Quezon, attaching therewith a copy of Sangguniang Bayan Resolution No. 159, S. 2002 passed by the same Sangguniang Bayan, opposing the instant application.

Relative thereto, on March 24, 2003, the Commission issued an Order directing QUEZELCO II to submit its comment on the said Resolution. However, QUEZELCO II did not file any comment on the aforesaid Resolution.

On August 1, 2003, QUEZELCO II filed its "Formal Offer of Evidence".

I. SUMMARY OF QUEZELCO II's APPLICATION

I.A. REVENUE REQUIREMENT

QUEZELCO II's revenue requirement per unbundled application based on Audited Financial Statements for the year 2000 was as follows:

Account Name	TEST YEAR	
Purchased Power	PhP	39,940,827
Payroll		8,983,635
Operation and Maintenance (less Fuel, Purchased Power & Payroll)		12,340,257
Debt Service		5,260,792
Revenue Requirement		66,525,511
Less: Other Revenue Items		2,651,783
Reinvestment Fund (5%) ¹		3,193,686
TOTAL REVENUE REQUIREMENT	PhP	67,067,414

QUEZELCO II's proposed revenue requirement was PhP 67,067,414 based on historical costs for the year 2000. The Overall Average Tariff Adjustment (OATA) published was PhP 0.5231/kWh based on Schedule A year 2000.

QUEZELCO II also submitted Audited Financial Statements for the year 2000.

I.B. RATE STRUCTURE/DESIGN

The unbundled rates proposed by QUEZELCO II were as follows:

Residential		
Customer Charges		
Supply/Retail	PhP	40.2100 per customer/month
Metering Charge		24.5100 per customer/month
Energy Charge		4.9769 per kWh
Universal Charge-Lifeline Subsidy		0.1696 per kWh
Customer Charge		
Supply/Retail		78.7600 per customer/month
Commercial		
Without Demand Meter:		
Customer Charges		
Supply/Retail		9.5100 per customer/month
Metering Charge		16.2100 per customer/month
Energy Charge		4.0551 per kWh
Universal Charge-Lifeline Subsidy		0.1696 per kWh

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

With Demand Meter:			
Customer Charges			
Supply/Retail	PhP	9.5100	per customer/month
Metering		16.2100	per customer/month
Energy Charge		4.0551	per kWh
Demand Charge		141.6100	per kW
Universal Charge-Lifeline Subsidy		0.1696	per kWh
Industrial			
Customer Charges			
Supply/Retail		9.4000	per customer/month
Metering Charge		15.3200	per customer/month
Demand Charge		139.1800	per kW
Energy Charge		4.0817	per kWh
Universal Charge-Lifeline Subsidy		0.1696	per kWh
Public Buildings			
Customer Charges			
Supply/Retail		10.3300	per customer/month
Metering Charge		22.9500	per customer/month
Demand Charge		173.1500	per kW
Energy Charge		3.8290	per kWh
Universal Charge-Lifeline Subsidy		0.1696	per kWh
Street Lights			
Customer Charge			
Supply/Retail		6.8100	per customer/month
Energy Charge		4.7481	per kWh
Universal Charge-Lifeline Subsidy		0.1696	per kWh
Water System			
Customer Charges			
Supply/Retail		14.3800	per customer/month
Metering		55.8200	per customer/month
Energy Charge		3.8608	per customer/month
Demand Charge		170.3500	per kW
Universal Charge-Lifeline Subsidy		0.1696	per kWh

I.B.1. FUNCTIONALIZATION, CLASSIFICATION and ALLOCATION

All the functionalization and the allocation factors used by QUEZELCO II were default factors provided in the UFR prescribed by the Commission. These were adopted by QUEZELCO II as applicable to its operations.

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

I.B.2. SYSTEM LOSS

The system loss reflected in QUEZELCO II's unbundling application, particularly Schedule J: System Loss, was 12.32%.

I.B.3. INTER-CLASS CROSS SUBSIDY

QUEZELCO II 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	49,199,141	52,709,422	3,510,281
Commercial	15,261,021	12,329,132	(2,931,889)
Industrial	618,064	483,539	(134,525)
Public Buildings	670,445	489,333	(181,112)
Street Lights	769,831	654,263	(115,568)
Water System	548,912	401,725	(147,187)
Total	67,067,414	67,067,414	0

I.B.4. LIFELINE RATE and LEVEL

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

	Option 1 (At Existing Rate)	Option 2 (At Proposed Rate)
Level	15/kWh	15 kWh
Rate	PhP 5.2507/kWh	PhP 9.2914/kWh ²

I.C. OTHER CHARGES

QUEZELCO II, in its subsequent submission, provided this Commission with information on its existing Other Charges as shown below. QUEZELCO II submitted proposed charges for other services.

PARTICULARS	RATES
1. Cost of Wires	
Duplex Wire #6	PhP 19.00/meter
Duplex Wire #2	42.00/meter
2. Membership Fees	5.00
3. Inspection Fees	50.00
4. Others	
lead seal	2.00
wood screw	0.75
staple wire	2.00
wire grip/compression tap	65.00
Ground rod & connector	323.40

² Based on QUEZELCO II's UFR Application - Sub-Schedule H-3

II. COMMISSION DISCUSSIONS and CONCLUSIONS

II.A. DETERMINATION OF TOTAL REVENUE REQUIREMENT

II.A.1. TEST YEAR

The Commission finds QUEZELCO II'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, QUEZELCO II is buying power from two (2) sources, namely: National Power Corporation (NPC) Main and NPC Small Power Utilities Group (SPUG).

The town of Polillo, Patnanungan, and Jomalig are being served by NPC-SPUG . The rest of the franchise areas are being served by NPC-Main. Hence, the generation rates are different for QUEZELCO II-Mainland and SPUG.

The Generation and Transmission charges shall reflect the generation charges of the NPC as approved in the Commission's Orders dated February 24, 2003 and May 15, 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)] and 2003-156 [In the Matter of the Application for the Recovery of Fuel and Independent Power Producer Costs Under the Generation Rate Adjustment Mechanism (GRAM)], respectively; and the transmission charges of the National Transmission Corporation (TRANSCO) as approved in ERC Orders dated September 6 and 20, 2002, 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 Case No. 2002-01 dated December 20, 2002 [In the Matter of the Application for the Approval of the Unbundled Rates and Basic Rate Increase in the Small Island Grids, National Power Corporation (NPC) – Applicant]. The FOREX component of NPC's Generation Rate used for QUEZELCO II – Main pertains to the supply month of August 2003 amounting to PhP 0.2506 per kWh. A separate charge to account for the allowable system loss shall likewise be provided (please refer to Section II.B.2.d. for details). Hence, a distribution utility with 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 Commission made an upward adjustment of PhP 5,670,410 to the Purchased Power as shown below:

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.*

Adjustment to Purchased Power Cost	PhP	6,316,366
Adjustment to System Loss		(645,956)
Net Adjustment		5,670,410

The adjustment to Purchased Power Cost of PhP 6,316,366 pertains to the difference between the Generation and Transmission Charges based on the new rates of NPC and TRANSCO amounting to PhP 46,257,193 (PhP 37,942,063 for NPC Main Area and PhP 8,315,130 for NPC-SPUG Area) and the proposed Purchased Power of QUEZELCO II amounting to PhP 39,940,827.

Records show that QUEZELCO II's average system loss (excluding cooperative's own use) for the years 2000, 2001 and 2002 was 15.46% and 9.21% for Main Area and SPUG Area, respectively.

The Commission allowed a system loss of 14% for Main Area and 9.21% for SPUG Area in the calculation of QUEZELCO II's revenue requirement as discussed in Section II.B.2.d. of this Decision. Thus, the Commission made a total adjustment to system loss of PhP 645,956 which represents the excess of actual system loss over the allowable recoverable cap of PhP 6,166,220.

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

Generation Charge	PhP	32,140,167
Transmission Charge		7,304,850
Recoverable System Loss		6,166,220
Total	PhP	45,611,237

QUEZELCO II's approved generation charges shall remain fixed until changes in the generation rates of NPC-Main and NPC-SPUG are approved and authorized by the Commission pursuant to its Orders dated February 24, 2003, Case Nos. 2003-44 [In the Matter of the Adoption of the Generation Rate Adjustment Mechanism (GRAM) and Incremental Currency Exchange Recovery Adjustment (ICERA)] and 2003-156 [In the Matter of the Application for the Recovery of Fuel and Independent Power Producer Costs under the Generation Rate Adjustment Mechanism (GRAM)], respectively. In which case, QUEZELCO II shall bill its end-users the new generation rate charged by NPC. In the meantime, QUEZELCO II shall discontinue charging the Purchased Power Adjustment (PPA) upon effectivity of the 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.

II.A.3. PAYROLL

The Commission finds QUEZELCO II's payroll amounting to PhP 8,983,635 acceptable.

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 an electric distribution utility, are recurring, and should redound to the service or benefit of end-users.

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

company for its end-users, with a mandate to advocate and transact judiciously for and in their behalf.

“Reasonable costs” may be defined as the cost of those goods and services which, while may not be the lowest in price, need to be incurred with consideration of quality, efficiency, reliability, and security, which are characteristics of the service that should be delivered by the distribution utility. “Prudent costs” demand that the utility ensures that its purchases of goods and services are at their minimum, without sacrificing the foregoing characteristics. When making a purchase or executing a contract, it cannot simply rely on its right to pass on its costs to its end-users.

As such, the Commission, in fulfillment of the policy of R.A. 9136 to establish a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency, enjoins QUEZELCO II 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.

QUEZELCO II'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 QUEZELCO II's viability. To this end, QUEZELCO II should view a petition for an increase in rates to be the last recourse. In future filings, QUEZELCO II 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 did not consider expenses of PhP 5,587,116 [inclusive of Customer Prompt Payment Discount of PhP 637,189 which was re-classified under Other Revenue Items (ORI)] which consist of deferred debits, meals, snacks raffle prizes, donations, cash gifts to security guards, anniversary bonus, coop awards, financial assistance, honorarium, lighting allowance, meal subsidy, GM's house rental and other expenses and lighting allowance which were found to have gone beyond the necessity by which these expenses were meant for. The expenses were excluded for revenue requirement determination. These expenses translate to PhP 0.4030/kWh which the Commission considers material.

For future rate cases, QUEZELCO II 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. QUEZELCO II 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 REVENUE ITEMS

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

The Commission encourages QUEZELCO II to improve its financial condition through the development of other related sources of revenue. However, in order to balance the interests of QUEZELCO II 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 the total revenue requirement by 50% of the total ORI. This reduction of 50% which resulted in an adjustment of PhP 1,647,111 is computed as shown below:

Other Revenue Items	Amount (PhP)
Other Revenues:	
Prompt Payment Discount from NPC	1,095,370
Rent from Electric	252,772
Other Electric Revenue	1,303,640
Total Other Revenues	2,651,782
Other Expenses:	
Customer Prompt Payment Discount	(637,189)
Non-Operating Expenses	(5,250)
Total Other Expenses	(642,439)
Other Revenue Items	2,009,343
50% of the above	1,004,672
ORI already reflected by QUEZELCO II in its UFR	2,651,783
Adjustment	(1,647,111)

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

II.A.6. DEBT SERVICE

The Commission finds QUEZELCO II's debt service amounting to PhP 5,260,792 acceptable as it is consistent with NEA's records. The details are shown below.

LOANS	LOAN PROFILE		DIFFERENCE (PhP)
	PER NEA * (PhP)	PER QUEZELCO II (PhP)	
RURAL ELECTRIFICATION:			
A	417,376	417,376	
B1	531,164	531,164	
B2	221,788	221,788	
C	146,988	146,988	
D	475,788	475,788	
E	631,824	631,824	
CONSTRUCTION A	1,031,364	1,031,364	
WB-RERP –LOG	995,604	995,604	
CONCESSIONAL	349,384	349,384	
LOGISTICAL	142,716	142,716	
RURAL ELECTRIFICATION –FR	40,552	40,552	
RURAL ELECTRIFICATION –B	276,244	276,244	
TOTAL	5,260,792	5,260,792	0

* Net of construction Loan B in the amount of PhP 77,392 which was fully paid on June 30, 2002.

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. QUEZELCO II applied for a rate reduction under the Guidelines for the Implementation of the Reduction in Rates of the Electric Cooperatives Due to the Condonation of Debts issued by the Commission on October 21, 2002, as amended on November 15, 2002.

The Commission, in its Order dated July 21, 2003, granted QUEZON II a Provisional Authority to reduce its rates by PhP 0.1250/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

The Commission permits a reinvestment fund of PhP 3,452,849 equivalent to 5% of QUEZELCO II's Gross Revenue to finance expansion and rehabilitation/upgrading of its existing electric power system in accordance with the submitted System Rehabilitation/Upgrading and/or System Loss Reduction Plan. This resulted in an upward adjustment of PhP 259,163 in the reinvestment fund account.

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

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

- d) QUEZELCO II shall submit a new System Rehabilitation/Upgrading and/or System Loss Reduction Plan covering the period 2004 to 2008, no later than 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 QUEZELCO II:

Account Name	QUEZELCO II Proposal	Adjustments	ERC Approval
Purchased Power	39,940,827	5,670,410	45,611,237
Payroll	8,983,635	0	8,983,635
Operation & Maintenance (less Purchased Power & Payroll)	12,340,257	(5,587,116)	6,753,141
Debt Service	5,260,792	0	5,260,792
Reinvestment Fund (5%)	3,193,686	259,163	3,452,849
Other Revenue Items	(2,651,783)	1,647,111	(1,004,672)
Total Revenue Requirement	67,067,414	1,989,568	69,056,982

QUEZELCO II proposed an OATA of PhP 0.5231/kWh using rates of year 2000 (as discussed in Section I.A. of this Decision). 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 1,989,568 approves a total revenue requirement of PhP 69,056,982 equivalent to an OATA⁴ of PhP 0.1066/kWh. 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 The OATA was computed using existing approved distribution rates (inclusive of current WAC, if any) and unbundled power cost as of August 2003.

II.B. RATE STRUCTURE/DESIGN DETERMINATION

II.B.1 FUNCTIONALIZATION, CLASSIFICATION and ALLOCATION

The functionalization and allocation factors used by QUEZELCO II were the default factors provided for in the UFR issued by the Commission on October 30, 2001. In the case of QUEZELCO II, 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 QUEZELCO II for functionalization and allocation were modified, to wit:

First, the use of the 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 the transmission function.

Third, since the Commission is now including Other Revenue Items (ORI) not included by QUEZELCO II, 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	0.2705	0.6599	0.0696

QUEZELCO II submitted a classification of distribution costs into demand-and customer-related cost using the Minimum-Plant Method. This method resulted in a 57%-43% allocation on the average.

II.B.2. DESIGN and CALCULATION OF CHARGES

II.B.2.a. 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, the Commission’s Orders dated September 6 and 20, 2002 and ERC Case No. 2002-01 [In the Matter of the Application for the Approval of the Unbundled Rates and Basic Rate Increase in the Small Island Grids, National Power Corporation (NPC) – Applicant], the generation charge to be billed to end-users shall be the approved rate per kilowatt-hour including Benefits to Host Communities and Franchise Charges and Foreign Exchange Rate Adjustment (FOREX) for NPC Main and Basic Rate, Fuel Cost Adjustment (FCA) and Foreign Exchange Rate Adjustment (FOREX) for NPC-SPUG. The approved rates of NPC Main and NPC-SPUG will remain fixed until changes are authorized by the Commission pursuant to its Order dated May 15, 2003 as

discussed in Section II.A.2. of this Decision. This allows QUEZELCO II's Generation Charges (for the Mainland & Polillo, Patnanungan and Jomalig Island) to remain fixed until such time that NPC's approved rates are adjusted. This eliminates the need for future Purchased Power Adjustment (PPA).

II.B.2.b. 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 QUEZELCO II 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 QUEZELCO II (Mainland) 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	Commercial	Industrial	Communal Water System	Public Buildings	Street Lights
Year 1						
Demand Charge PhP/kW						
Transmission Line Charge PhP/kWh	0.7536	0.6119	0.6560	0.5309	0.5471	0.7197
Year 2						
Demand Charge PhP/kW						
Transmission Line Charge PhP/kWh	0.8892	0.7221	0.7741	0.6265	0.6455	0.8493
Year 3						
Demand Charge PhP/kW						
Transmission Line Charge PhP/kWh	1.0249	0.8323	0.8922	0.7221	0.7441	0.9789
Year 4						
Demand Charge PhP/kW						
Transmission Line Charge PhP/kWh	1.1606	0.9424	1.0103	0.8177	0.8425	1.1084

QUEZELCO II – Polillo, Patnanungan, and Jomalig is being served by NPC-SPUG. Distribution utilities sourcing power from NPC-SPUG have no transmission-related charge except for the areas of Mindoro and Palawan. Therefore, QUEZELCO II – Polillo, Patnanungan, and Jomalig end-users should not be billed a transmission charge.

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. The Commission rules that for QUEZELCO II – NPC Mainland, the System Loss Charge for all end-users shall be PhP 0.5254/kWh. For QUEZELCO II – Polillo, Patnanungan and Jomalig, the System Loss Charge for all end-users shall be PhP 0.3843/kWh.

The allowed system loss (exclusive of the cooperative's own use) is equal to the average system loss for years 2000, 2001 and 2002 or the system loss cap, whichever is lower. In arriving at this decision, the Commission recognizes that the distribution utility faces some risk of over- or under-recovery in the event its load characteristics change through time. The system loss 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 discussed 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 the IRR provide that the recoverable Technical and Non-Technical System Loss should not exceed the fourteen percent (14%) ceiling allowed for year 2000.

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

The Commission found that QUEZELCO II's 2000 to 2002 average system losses were 15.46% and 9.21% for the Mainland and Polilio,

Patnanungan and Jomalig Island, respectively. Hence, the Commission considered 14% system loss cap for the former and 9.21% for the latter in the calculation of QUEZELCO II's revenue requirement.

II.B.2.e. DISTRIBUTION CHARGE

The distribution charge shall be billed on a fixed rate per kilowatt-hour for all end-users.

QUEZELCO II did not propose for distribution wheeling rates. The Commission believes that wheeling rates are parallel to the cost of service functionalized under Distribution. Thus, the Commission orders that the Distribution Charge provided on Rate Schedules be likewise utilized as Distribution Wheeling Charges available to the future contestable market. Other distribution utilities requesting to wheel power across QUEZELCO II'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, the Commission orders QUEZELCO II to use a combination of PhP 5.00 per meter per month and a PhP 0.2850 per kWh rate for the metering function and orders QUEZELCO II to use a PhP per kWh rate for the supply function. For Commercial, Industrial, Communal Water System, Public Buildings and Street Lights end-users, metering charge shall be billed a fixed rate per meter per month. The supply charge shall be billed on a fixed PhP per customer per month for all end-users (except the residential).

II.B.2.g. POLILLO, PATNANUNGAN and JOMALIG ISLAND RATES

The Commission acknowledges that the revenue requirement for the operation of Polillo, Patnanungan and Jomalig Island was included in the unbundling of rates application of QUEZELCO II.

However, since the system of Polillo, Patnanungan and Jomalig Island is not interconnected to the Mainland and it sources its power from NPC-SPUG, QUEZELCO II is authorized to bill its end-users of Polillo, Patnanungan and Jomalig Island an unbundled generation charge not to exceed the NPC-SPUG Generation Charge of PhP 3.7064 per kWh and a System Loss charge of PhP 0.3843 per kWh. In addition, QUEZELCO II shall not bill its end-users hereto of any transmission charge. As for all other charges, QUEZELCO II shall apply the same unbundled rates specified for each customer class in this Decision.

II.B.3. INTER-CLASS CROSS SUBSIDY

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

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

	Total	Residential	Commercial	Industrial	Communal Water System	Public Bldg.	Street Lights
New Cost-Based Revenue Requirement PhP	69,056,982	53,416,441	13,264,358	555,033	422,959	674,684	723,507
Existing Rates Revenue PhP	67,750,224	49,889,283	15,130,810	626,264	562,899	844,110	696,858
Total Change in Revenue PhP	1,306,758	3,527,158	(1,866,452)	(71,231)	(139,940)	(169,426)	26,649
Percentage Change in Revenue	1.93%						
Normalized Existing Revenue PhP	69,056,982	50,851,541	15,422,651	638,344	573,756	860,391	710,299
Inter-Class Cross Subsidy Amounts PhP	0	(2,564,900)	2,158,293	83,311	150,797	185,707	(13,208)
Class Billing Determinants kWh	12,281,444	9,091,385	2,693,620	113,630	101,791	152,861	128,157
Inter-Class Cross Subsidy Rates PhP/kWh		(0.2821)	0.8013	0.7332	1.4814	1.2149	(0.1031)

II.B.3.b. CROSS SUBSIDY REMOVAL

Section 74 of R.A. 9136 and Rule 16, Section 5 of the Implementing Rules and Regulations thereof 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 the TRANSCO in its Decision dated June 26, 2002, Case No. 2001-901, which impacts the unbundled transmission rates for QUEZELCO II'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, QUEZELCO II 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-user 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 QUEZELCO II. The Commission considers the impact that the subsidized Lifeline Rates will have on other end-users who must carry the costs associated with such subsidy. This fact, combined with the desire to maximize the benefit to as many marginalized end-users as possible, has led the Commission to adopt the following graduated scale for lifeline discount for QUEZELCO II. The graduated scale is also based on the recognition that individual end-users consumption may likely vary from month to month.

15 kWh and below	-	30%
16 kWh	-	25%
17 kWh	-	20%
18 kWh	-	15%
19 kWh	-	10%
20 kWh	-	5%

QUEZELCO II shall apply these discount to the following residential charges: Generation, Transmission, Distribution, Supply, Metering and System Loss. In a given billing period, an end-user with a maximum consumption of 20 kWh 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 QUEZELCO II, the lifeline discounts result in a Lifeline Rate Subsidy by other end-users equal to PhP 0.0767/kWh.

II.B.5. OTHER CHARGES

QUEZELCO II'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 QUEZELCO II. 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 may be revisited.

The Other Charges of QUEZELCO II are hereby pegged at their existing levels until such time that the Commission sets new rates on the same. Further, QUEZELCO II 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 shall not be limited to the amount of actual time and wages of employees performing each task encompassed by each type of Other Charges.

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

A comparison of the estimated impact of all adjustments on the revenue requirement on the monthly bill of an average residential end-user consuming 64 kWh a month, using rates based on QUEZELCO II's actual existing rates as of August 2003 against the unbundled rates approved by the Commission, is shown below.

For QUEZELCO II's end-users in the NPC Mainland:

Based on Actual Existing Rates			Based on ERC Approved Unbundled Rates			
	PhP/kWh	Amount (PhP)			PhP/kWh	Amount (PhP)
Basic Rate	3.7363	239.12	Generation Charges:		2.4009	153.66
PPA	1.7072	109.26	Generation System Charge-Main	2.1258		
WAC	0.1306	8.36	Benefits to Host Communities Charge	0.0245		
PAR	(0.3000)	(19.20)	FOREX	0.2506		
Universal Charge:						
Missionary Electrification	0.0373	2.39	Transmission Charge		0.7536	48.23
Environmental Charge	0.0025	0.16	Distribution Charge		1.2239	78.33
			System Loss Charge		0.5254	33.63
			Supply Charge		0.5186	33.19
			Metering Charges:			
			Per Meter Per Month			5.00
			Per kWh		0.2850	18.24
			Inter-Class Cross Subsidy		(0.2821)	(18.05)
			Lifeline Rate [(Discount)/Subsidy]		0.0767	4.91
			Power Act Reduction		(0.3000)	(19.20)
			Universal Charge:			
			Missionary Electrification		0.0373	2.39
			Environmental Charge		0.0025	0.16
TOTAL BILL		340.09	TOTAL BILL			340.49
PhP/kWh		5.3139	PhP/kWh			5.3202
Missionary Electrification Charge The PhP 0.0373/kWh is based on the final authority granted by ERC in its Decision dated June 26, 2003 on ERC Case No. 2002-165.						

For QUEZELCO II's end-users in Polillo, Patnanungan and Jomalig – NPC SPUG

Based on Actual Existing Rates			Based on ERC Approved Unbundled Rates			
	PhP/kWh	Amount (PhP)			PhP/kWh	Amount (PhP)
Basic Rate	3.7363	239.12	Generation Charges:		3.7064	237.21
PPA	1.7072	109.26	Transmission Charge			
WAC	0.1306	8.36	Distribution Charge		1.2239	78.33
PAR	(0.3000)	(19.20)	System Loss Charge		0.3843	24.60
Universal Charge:			Supply Charge		0.5186	33.19
Missionary Electrification	0.0373	2.39	Metering Charges:			
Environmental Charge	0.0025	0.16	Per Meter Per Month			5.00
			Per kWh		0.2850	18.24
			Inter-Class Cross Subsidy		(0.2821)	(18.05)
			Lifeline Rate [(Discount)/Subsidy]		0.0767	4.91
			Power Act Reduction		(0.3000)	(19.20)
			Universal Charge:			
			Missionary Electrification		0.0373	2.39
			Environmental Charge		0.0025	0.16
TOTAL BILL		340.09	TOTAL BILL			366.78
PhP/kWh		5.3139	PhP/kWh			5.7309
Missionary Electrification Charge The PhP 0.0373/kWh is based on the final authority granted by ERC in its Decision dated June 26, 2003 on ERC Case No. 2002-165.						

DISPOSITION

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

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

For QUEZELCO II's end-users in the Mainland:

	Residential	Comm.	Industrial	Comm. Water System	Public Bldg.	Street Lights
Generation Charges:						
Generation System Charge PhP/kWh	2.1258	2.1258	2.1258	2.1258	2.1258	2.1258
Franchise & Benefits to Host Communities Charge PhP/kWh	0.0245	0.0245	0.0245	0.0245	0.0245	0.0245
FOREX Adjustment Charge PhP/kWh	0.2506	0.2506	0.2506	0.2506	0.2506	0.2506
Transmission Charges:						
Demand Charge PhP/kWh						
Transmission System Charge PhP/kWh	0.7536	0.6119	0.6560	0.5309	0.5471	0.7197
System Loss Charge: PhP/kWh	0.5254	0.5254	0.5254	0.5254	0.5254	0.5254
Distribution Charges:						
Demand Charge PhP/kWh						
Distribution System Charge PhP/kWh	1.2239	1.1131	1.0578	0.6535	0.6146	1.2308
Supply Charges:						
Retail Customer Charge PhP/Cust./Mo.		29.82	29.82	30.47	30.01	29.68
Supply System Charge PhP/kWh	0.5186					
Metering Charges:						
Retail Customer Charge PhP/Meter/Mo.	5.00	26.64	26.64	11.99	19.32	11.99
Metering System Charge PhP/kWh	0.2850					
Inter-Class Cross Subsidy Charge: PhP/kWh	(0.2821)	0.8013	0.7332	1.4814	1.2149	(0.1031)
Lifeline Rate (Discount)/Subsidy PhP/kWh	0.0767	0.0767	0.0767	0.0767	0.0767	0.0767
Universal Charge:						
Missionary Electrification Charge PhP/kWh	0.0373	0.0373	0.0373	0.0373	0.0373	0.0373
Environmental Charge PhP/kWh	0.0025	0.0025	0.0025	0.0025	0.0025	0.0025
Loan Condonation * PhP/kWh	(0.1250)	(0.1250)	(0.1250)	(0.1250)	(0.1250)	(0.1250)
Power Act Reduction: PhP/kWh	(0.3000)					
Lifeline Rate (Discount)/Subsidy	To be based on Residential rate in a graduated scale as provided in Section II.B.4 this Decision					
Missionary Electrification Charge	The PhP 0.0373/kWh is based on the final authority granted by ERC in its Decision dated June 26, 2003 on ERC Case No. 2002-165.					
* Effective on the next billing cycle after receipt of Order on ERC Case No. 2003-90 dated July 21, 2003.						

For QUEZELCO II's end-users in Polillo, Patnanungan and Jomalig:

		Residential	Comm.	Comm. Water System	Public Bldg.	Street Lights
Generation Charges:						
Generation System Charge	PhP/kWh	3.7064	3.7064	3.7064	3.7064	3.7064
Franchise & Benefits to Host Communities Charge	PhP/kWh					
FOREX Adjustment Charge	PhP/kWh					
Transmission Charges:						
Demand Charge	PhP/kWh					
Transmission System Charge	PhP/kWh					
System Loss Charge:	PhP/kWh	0.3843	0.3843	0.3843	0.3843	0.3843
Distribution Charges:						
Demand Charge	PhP/kWh					
Distribution System Charge	PhP/kWh	1.2239	1.1131	0.6535	0.6146	1.2308
Supply Charges:						
Retail Customer Charge	PhP/Cust./Mo.		29.82	30.47	30.01	29.68
Supply System Charge	PhP/kWh	0.5186				
Metering Charges:						
Retail Customer Charge	PhP/Meter/Mo.	5.00	26.64	11.99	19.32	11.99
Metering System Charge	PhP/kWh	0.2850				
Inter-Class Cross Subsidy Charge:	PhP/kWh	(0.2821)	0.8013	1.4814	1.2149	(0.1031)
Lifeline Rate (Discount)/Subsidy	PhP/kWh	0.0767	0.0767	0.0767	0.0767	0.0767
Universal Charge:						
Missionary Electrification Charge	PhP/kWh	0.0373	0.0373	0.0373	0.0373	0.0373
Environmental Charge	PhP/kWh	0.0025	0.0025	0.0025	0.0025	0.0025
Loan Condonation :	PhP/kWh	(0.1250)	(0.1250)	(0.1250)	(0.1250)	(0.1250)
Power Act Reduction:	PhP/kWh	(0.3000)				
Lifeline Rate (Discount)/Subsidy To be based on Residential rate in a graduated scale as provided in Section II.B.4 of this Decision						
Missionary Electrification Charge The PhP 0.0373/kWh is based on the final authority granted by ERC in its Decision dated June 26, 2003 on ERC Case No. 2002-165.						
* Effective on the next billing cycle after receipt of Order on ERC Case No. 2003-90 dated July 21, 2003.						

2. To direct QUEZELCO II 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 0.0373/kWh representing the missionary electrification portion of the Universal Charge in accordance with the Decision of the Commission in ERC Case No. 2002-165 (In the Matter of the Petition for the Availment from the Universal Charge the Share for Missionary Electrification, NPC-SPUG, Applicant);

- d) Bill PhP 0.0025/kWh representing the environmental portion of the Universal Charge in accordance with the Decision of the Commission in ERC Case No. 2002-194 (In the Matter of the Petition for the Availment from the Universal Charge the Environmental Share/Charge for the Rehabilitation and Management of Watershed Areas, NPC, 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 value 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 no later than one (1) year after the date of this Decision and every year thereafter, using the prescribed formats provided in Annexes B and C of this Decision. The report shall include detailed accounting of actual collections and deposits (including interest and dividend income), specific transactions and withdrawals for all disbursements and actual current system losses;

- k) Submit a new System Rehabilitation/Upgrading and/or System Loss Reduction Program covering the period 2004 to 2008, no later than one (1) year after the date of this Decision using a format to be prescribed by the Commission; and

- l) Institute policies and procedures for cost-cutting and transparent and competitive procurement of goods and services and submit a report thereon to the Commission within six (6) months from receipt of this Decision.

SO ORDERED.

Pasig City, September 25, 2003.

MANUEL R. SANCHEZ
Chairman

OLIVER B. BUTALID
Commissioner

CARLOS R. ALINDADA
Commissioner

LETICIA V. IBAY
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