

SCHEDULE C1.4

Justification for Capital Expenditures (Major and Minor Projects)

Definition

Capital Expenditures (CAPEX) are those expenses incurred on property (excluding intellectual property), plant or equipment to:

- augment the capacity of the network to meet demand growth;
- replace ageing and obsolete assets;
- extend the useful lives of network assets to beyond the standard regulatory lives;
- improve the quality and reliability of supply;
- make capital improvements that are necessary for meeting the established service quality targets and/or technical and safety obligations imposed by regulatory or statutory agencies; and
- purchase or construct Non-network Assets required for the normal efficient operation of the Regulated Distribution System.

Cost components that can be capitalized are the following:

- purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use, e.g., cost of site preparation, initial delivery and handling costs, installation costs, professional fees such as for architects, engineers and project managers, and estimated cost of dismantling and removing the asset and restoring the site, and the estimated costs of dismantling and removing the asset as a provision under IAS 37, Provisions, Contingent Liabilities and Contingent Assets;
- borrowing costs allowed under IAS 23, to the extent that these are not already recovered through the Construction Work-In-Progress (CWIP) factor;
- administration and other general overhead costs and start-up and similar preproduction costs which are directly attributed to the acquisition of the property, plant and equipment and/or bringing the asset to its working condition; and
- major spare parts and stand-by equipment qualifying as property, plant and equipment.

For subsequent expenditures on assets, capitalization shall be done only when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the Regulated Entity. As such, the expenditure improves the condition of the asset beyond its originally assessed standard of performance, as follows:

- modification of an asset to extend its useful life, or increase its capacity;
- upgrade of assets to achieve a substantial improvement in the quality of output; and
- adoption of new production processes enabling a substantial reduction in previously assessed operating costs.

ILPI Capitalization Approach

Generally and historically, ILPI capitalizes expenditures on assets based on the parameters enumerated above with the exception of the treatment of labor costs associated with projects and asset acquisitions which are expensed outright. Accordingly, the historical CAPEX provided do not include labor components. However, CAPEX forecasts prepared for the Regulatory Period (RP) 2009-2013 have labor costs incorporated in the estimates.

Asset Categorization

As specified in clause 4.8.5 of the Rules for Setting Distribution Wheeling Rates (RDWR), expenditures have to be broken down into the following asset categories:

- Regulated Distribution Services;
- Distribution Connection Services; and
- Regulated Retail Services.

For ILPI, historical and forecasted CAPEX have been matched as reasonably as possible to the categorization required. Charges to Distribution Connection Services have been limited to the costs of Services (Service Drops) lodged under Overhead Conductors and Devices as agreed with the Reset Consultant.

With regards labor and overhead costs, these have been included in the forecasts as mentioned earlier but not charged along with material costs to respective asset accounts. These would have been charged under the Allocated Overhead Account had it been available in the templates. Nevertheless, estimated costs have been charged to Miscellaneous Equipment.

Categorization of Capital Expenditures

In addition to the categorization specified in the RDWR, CAPEX have to be classified into Distribution System related and Non-network related and further sub-classified into Load Growth, Asset Renewal and Asset Refurbishment. Also, Major expenditures have to be separately identified.

For ILPI, CAPEX have been prepared based on the following classifications:

- Major
These are projects undertaken and asset acquisitions exceeding the lesser of 30% of the total Capital Expenditure for a Regulatory Year (RY) or PhP 50 Million.

Based on the limit, CAPEX for the years 2004 to 2007 of ILPI do not qualify as Major CAPEX. Consequently, there is no Major CAPEX in the historical data provided.

In the CAPEX forecasts, some projects were identified as Major despite the fact that estimated costs have not reached the threshold amounts. These were identified based on their importance of implementation.

- Load Growth
These are projects undertaken or asset acquisitions to renew assets because they can no longer meet growing demands.

These also include asset acquisitions to capture additional customers as in the case of the transferred Sub-transmission Assets.

- Renewal
These are projects undertaken or asset acquisitions to replace existing assets due to their deteriorating condition, due to technological obsolescence, when the anticipated economic cost of operating, refurbishing and maintaining the assets exceed that to renew them.
- Refurbishment
These are projects undertaken or asset acquisitions to increase the serviceability of assets to beyond their normal standard asset lives.

Basis of Estimates

Cost estimates are based on quotations of suppliers and contractors, and when applicable, the Replacement Costs from the recent Asset Valuation were used.

Introduction to ILPI

To provide a better understanding of ILPI's various plans, projects and programs, we are providing herein a background of the company, its distribution system and consumer profile.

Brief History

Iligan Light & Power, Inc., or ILPI, was founded in 1930 by Judge Candelario Borja and wife Consuelo when it acquired a 50-year franchise to operate the electric company in Iligan City per Act No. 3810. Formerly known as ILIGAN ELECTRIC LIGHT & POWER SUPPLY, it started operations in 1931 with a 30 kW diesel generating set which was destroyed during World War II. It resumed operations with a 37.5 kVa generating set acquired from the US Army Surplus Commission at peace time.

In 1975, it obtained a 25-year extension of its franchise until 2005 under Republic Act No. 6391. In 1976, the company was incorporated under the name: ILIGAN LIGHT & POWER, INC. In 1995, it got another 25-year franchise extension under Republic Act 8148 to end in 2030.

Vision

We are highly efficient and competent, preferred provider of electricity and related services, committed to the upliftment of quality of life, progress and development of the community.

Mission

We aspire and commit ourselves to –

- Bring the benefits of electrification to the greatest number of customers; with a quality of service that is within industry and international standards;
- Establish a learning organization and wholesome work environment; develop and maintain a competent professional work team with opportunities to achieve peak performance and gain optimum satisfaction from their jobs;
- Promote operational efficiency and reliability by continuously improving productivity and adapting new technologies to meet the changing demands and needs of the market;
- Ensure continued viability of the company, assuring shareholders of a reasonable return on their investments; and
- Operate with a social conscience while actively seeking ways to contribute to the economic and social development of Iligan City and its neighboring areas.

Medium-Term Objectives

To serve as anchor for its plans, programs and projects for the RP 2009-2013, ILPI has set its Medium-Term Objectives or Key Result Areas (KRA).

KRA I - PBR Performance Objectives

- Performance Rewards at Level III Standards
- Operation within PBR-committed System & Service Performance Indices on SAIFI, CAIDI, Planned SAIDI, Voltage Regulation, System Loss, Time to Process and Time to Connect
- Operational Performance within PBR-set Guaranteed Service Levels
- Up-to-Date Fixed Asset Registry
- Computerized Performance Tracking System by end of 2008
- Optimized use of Information and Communication Technology (ICT) by all Operating Units for Data Management and Operations

KRA II – System Reliability and Performance

- Quality, Reliability, Effectiveness, Efficiency and Safety in Power Distribution
- Constant and/or increased power factor at 90% standard set by the Department of Energy (DOE);
- Maintained and/or reduced system loss at 9.5% as set by the Energy Regulatory Commission (ERC) and the DOE;
- Voltage variation at $\pm 10\%$ of the nominal voltage of 220V at the secondary and 13,800V at the primary, set by the PGDC;
- N-1 compliant in the Power Transformer Substations & Main Feeder (backbone) lines;

- System Interruption Frequency Rate (IFR) limited at 5 times or less, the Cumulative Interruption Time (CIT) to 45 hours or less, and the Restoration Time (RT) to 600 minutes or less as set by DOE;
- Operation within the approved budget and due dates for expense items where the department has direct control and cost variance not exceeding to 10%;
- Zero accident caused by temporary and unsafe installation, negligence of personnel, and unsafe practices relating to work;
- Replaced at 20% annually the identified rotten and temporary poles;
- Zero downtime caused by transformer/equipment failures;
- Zero downtime caused by line obstructions;
- Measured, monitored and/or controlled power quality technical standards as required in the PGDC.

KRA III – Customer Service Performance

- Improved Customer Satisfaction
- Customer Education and Information on Customer Rights and Obligations
- Satellite Offices in Commercial Centers for Better Customer Accessibility
- Evaluation and Acquisition of Appropriate Hardware/Software to Monitor Customer Calls and Measure Response Time
- Customer Information Database Build-up to Measure Call Center Effectiveness within 12 Months before the start of the 2nd Regulatory Period
- Periodic Meter Testing as required by the Magna Carta

KRA IV – Financial Performance

- Optimized Return on Investment and Equity
- Compliance with Philippine Grid and Distribution Code's Financial Ratios
- Effective CAPEX Implementation

KRA V – Human Relations Development

- Development of Competent, Peak-Performing, Value-Driven Work Force
- Strengthened Employee Performance Evaluation System
- Enhanced Project Management Skills
- Acquisition of Other Specialized Skills as may be required in the Operation of the Distribution System
- Implemented Occupational Safety and Health Prescriptions

KRA VI – Corporate Social Responsibility

- Active Participation in Various National and Local Government Economic Programs
- Support of Deserving Local Community Projects

Distribution System Profile

The entire power requirement of ILPI is supplied by the state-owned National Power Corporation (NPC) within the Mindanao Grid where power generation sources are a mixture of Hydro, Oil and Geothermal.

Power is drawn from three (3) Metering Points:

- At the south: M1- OVERTON at 13.8 kV, TransCo-owned 32 MVA S/S, limited at 5MVA loading
- At the north: M2 - KIWALAN at 69 kV, 13.8 kV output, own 10 MVA S/S
- At the center: M3 - PALA-O at 69kv, 13.8kv output, own 40MVA S/S, operational at 32 MVA

System Peak Demand is at 34 MW; Power Factor at 94.46%; and Load Factor at 65.77%.

Consumer Profile

As of December 31, 2007, customer profile is as follows:

CUSTOMER CLASS	NUMBER OF CUSTOMERS	%
Flat Rate	4	0.009%
Residential	37,651	84.121%
Commercial	7,090	15.841%
Industrial	11	0.025%
Bulk Power	2	0.004%
TOTAL	44,758	100.000%

Market Share

	LOAD (kW)	% SHARE
Existing Business	34,305.00	26.71%
Directly Connected Load	94,136.00	73.29%
TOTAL	128,441.00	100.00%

Coming on-line with ILPI's purchase of TransCo's 69 kV Sub-transmission Line by 2009 are:

- Pillsbury Milling Corporation (Pilmico)
- Iligan Cement Corporation
- Treasure Steel Works Corporation

Coming on-line with ILPI's purchase of TransCo's Sub-transmission Connection Assets by 2011 are:

- Mabuhay Vinyl Corporation (with Own ST Line).
- Platinum Group Metals Corporation, formerly Ma. Cristina Chemicals, Inc. (with own ST Line, still to commence operation)

Coming on-line with ILPI's purchase of TransCo's 138 kV Sub-transmission Line by the Third Regulatory Period is:

- Global Steelmakers Corporation (138 kV)