



**REVIEW OF OPERATING AND MAINTENANCE
EXPENDITURE (OPEX) FORECAST:
SECOND REGULATORY PERIOD**

Cabanatuan Electric Corporation (CELCOR)

ADDENDUM

Prepared

by the

ENERGY REGULATORY COMMISSION (ERC)

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APPENDIX A: SUMMARY OF COMMENTS

1. INTRODUCTION

The Energy Regulatory Commission (ERC) has promulgated a performance-based form of regulation (PBR) for regulated privately owned electricity distribution utilities in the Philippines. Under the PBR framework, a regulated entity will be subject to a price cap for the delivery of distribution wheeling services. The reset process for the setting of the price cap for the six regulated entities entering the PBR at the third entry point is currently underway. This process will result in the setting of a maximum price path that will determine the maximum average price a regulated entity can charge for each year of the Second Regulatory Period (which commences on July 1, 2010 and ends on June 30, 2014).

The mechanism for the calculation of the price cap and the procedure and timelines for the introduction of this cap, are described in the Rules for Setting the Distribution Wheeling Rate (RDWR), which was released by the ERC on December 8, 2008¹. The ERC has also formulated its position on the reset process – as set out in a Position Paper dated December 8, 2008².

An important requirement of the reset process going forward is the review of the expenditure forecasts submitted by the DUs as part of their revenue applications filed with the ERC. These expenditure forecasts are critical to the determination of the revenue to which DUs are entitled and on which the price caps will be determined.

Section 4.13.4 of the RDWR requires that the expenditure forecasts provided by a DU be reviewed by a Regulatory Reset Expert/s in isolation or in cooperation with ERC staff as part of the PBR regulatory reset process. Geoff Brown and Associates (GBA) has been engaged by the ERC to provide guidance to the ERC staff to review the operating and maintenance expenditure (OPEX) forecasts and review the capital expenditure (CAPEX) forecasts, as well, of the six DUs entering PBR at the third entry point.

CELCOR submitted its PBR revenue application to ERC on June 15, 2009³ (Revenue Application). The Commission issued its report on its review of the OPEX forecasts included in CELCOR's Revenue Application on October 19, 2009⁴ (Review of Operating and Maintenance Expenditure (OPEX) Forecast: Second Regulatory Period). ERC issued a draft determination on the Revenue Application on November 9, 2009⁵ (Draft Determination). Following the release of the Draft Determination, ERC held a public consultation in Cabanatuan City on January 19, 2010. At the public consultation CELCOR raised a number of issues in respect of the Draft Determination and was required by the ERC to subsequently provide additional information to support its position. GBA and ERC staff were present at the public consultation and have now reviewed the additional information supplied by CELCOR insofar as this information relates to OPEX forecasts. In this Addendum to the Review of the Operating and Maintenance Expenditure Forecasts: Second Regulatory Period, ERC documents its review of the issues raised and, where appropriate, modifies the recommendations in the Review of the Operating and Maintenance Expenditure (OPEX) Forecast: Second Regulatory Period on CELCOR's reasonable OPEX requirements for the second regulatory period.

The issues that were discussed at the public consultation are summarized in Appendix A. Only those issues that could have a material impact on the OPEX approved in the Draft Determination are discussed in detail in the body of this Addendum.

¹ *Rules for Setting Distribution Wheeling Rates (RDWR) for Privately Owned Distribution Utilities Entering Performance Based Regulation (Third Entry Point)*, Energy Regulatory Commission, December 8, 2008.

² *Regulatory Reset for the July 2010 to June 2014 Regulatory Period for the Third Entry Group of Privately Owned Distribution Utilities subject to Performance Based Regulation, Position Paper*, Energy Regulatory Commission, December 8, 2008. Note that the start and finish dates of the regulatory period to which the Position Paper applies were subsequently changed to July 1, 2010 and June 30, 2014 respectively, by ERC resolution No. 24, Series of 2007, dated October 24 2007.

³ ERC Case No 2009-043RC

⁴ *Review of Operating and Maintenance Expenditure (OPEX) Forecast: Second Regulatory Period, Cabanatuan Electric Corporation, Inc. (CELCOR)*, ERC, October 19, 2009.

⁵ *Regulatory Reset for Cabanatuan Electric Corporation.(CELCOR) July 2010 to June 2014 (Second Regulatory Period) Draft Determination*, Energy Regulatory Commission, November 9, 2009.

2. EXECUTIVE SUMMARY

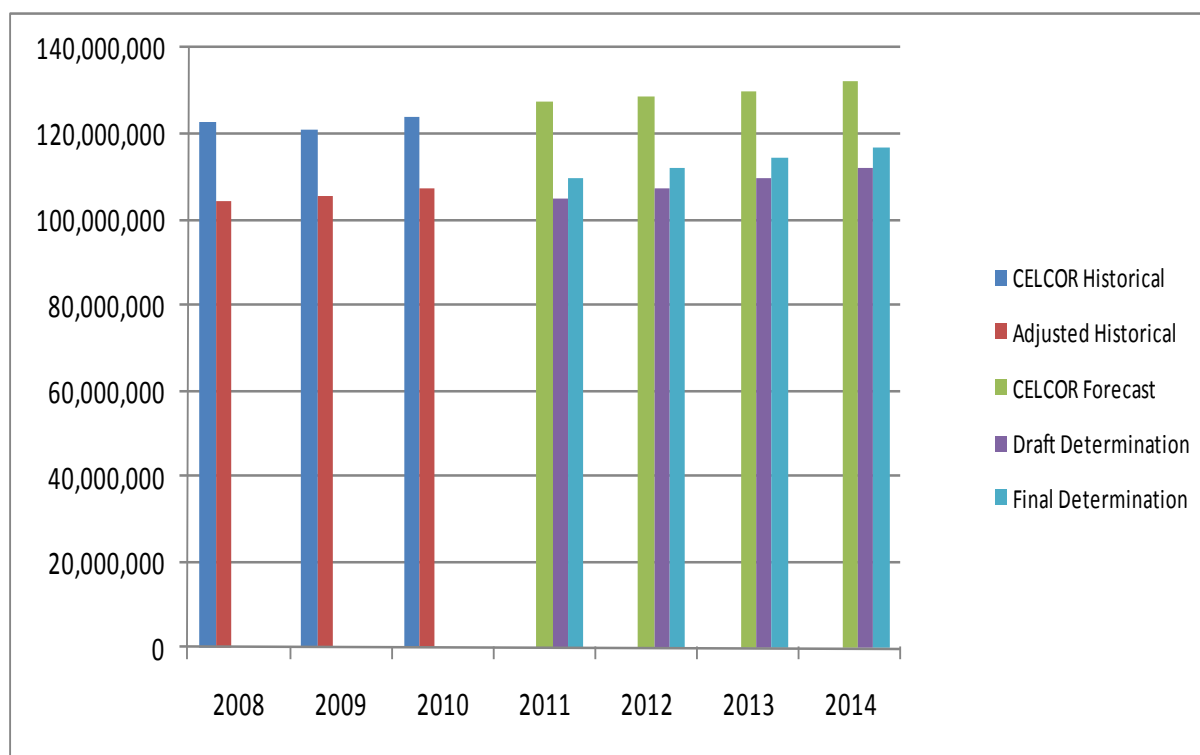
ERC made adjustments to the OPEX forecasts allowed in the Draft Determination considering the approved adjustments on the CAPEX forecasts as well as updated CPI data.

Table 1: Operating and Maintenance Expenditure Forecasts (PhP million, real 2009)

	RY 2010	RY 2011	RY 2012	RY 2013	RY 2014	Total ¹
Draft Determination	103.2244	104.8860	107.4246	109.7059	111.9250	537.1660
Adjustment to Distribution Operation and Maintenance	0.6004	0.9428	0.9884	0.9848	0.9816	4.4979
Adjustment to Administration and General	3.5051	3.5420	3.5554	3.5628	3.5701	12.6735
Adjustment to Regulated Retail Services	0.0074	0.0075	0.0078	0.0081	0.0084	0.0393
Total Adjustments	4.1129	4.4923	4.5517	4.5557	4.5601	17.2107
Revised OPEX Forecast	107.3373	109.3783	111.9763	114.2616	116.4851	554.3767

The adjustments allow for a partial reinstatement of major project CAPEX for RY 2010, the purchase of electronic meters for the metering of large commercial customers and also the purchase of substation spares.

The impact of these adjustments to the OPEX allowed in the Draft Determination is shown in the figure below.



ERC made further adjustments to the taxes, levies and duties allowed in the Draft Determination.

Table 2. Taxes, Levies and Duties Forecasts (PhP million, real 2009)

Year	CY 2009	RY 2010	RY 2011	RY 2012	RY 2013	RY 2014
Proposed in CELCOR's Revenue Application						
Taxes, Levies and Duties	0.7600	1.5005	2.3235	1.0284	1.0589	1.0677
Adjustments						
Real Property Tax	0	0.0000	-0.0117	-0.0600	-0.0825	-0.0825
Regulatory Reset Expert Fees	0	-0.7368	0.0000	0.0000	0.0000	0.0000
Real Property Tax - Bitas Coll Ofc	0	0.0097	0.0097	0.0097	0.0097	0.0097
Total Adjustments	0	-0.7271	-0.0019	-0.0503	-0.0727	-0.0727
Revised Taxes, Levies and Duties	0.7600	0.7734	2.3215	0.9781	0.9862	0.9950

Note: Using the ERC revised Economic Indices

3. OPERATING AND MAINTENANCE EXPENDITURE

3.1 PER DIEM AND EMPLOYEES BENEFITS (APPENDIX A - ITEM 6)

3.1.1 Background

In its comments on the Draft Determination, CELCOR indicated that additional benefits or non-wage benefits like morale booster, meal allowance, employees' welfare, fringe benefits, rice allowance and electric subsidy given to employees be allowed in the revenue requirement for the following reasons:

1. The National Wages and Productivity Commission of the Department of Labor and Employment (DOLE) issued Resolution No. 02 series of 2008 entitled "Encouraging Employers to Grant Non-Wage Benefits to Workers".
2. Other companies are offering high salaries, thus, most of CELCOR's well-trained and competent personnel are transferring to other companies. In order to remain viable in a highly competitive labor market, CELCOR's management decided to give the aforementioned non-wage benefits to the employees.
3. Per diem is the only remuneration that some of the directors are receiving in performing their duties.

CELCOR is requesting that these should be allowed in the Revenue Requirement.

3.1.2 Analysis

ERC made adjustments to its original recommendation to allow for rice subsidy as reasonable cost to be provided to its employees determined to be necessary for the conduct of its operations. It has been the Commission's policy that additional benefits provided to the Regulated Entities' employees should be sourced from their savings and not passed on to its customers. However, this does not preclude CELCOR to provide additional incentives or benefits to its employees provided that the associated cost or expenses are not passed on to its customers.

As described in the OPEX Review Report, the OPEX model forecasts specific cost categories by escalating the base year values by the correlated cost drivers. Distribution Operating and Maintenance expenditures are correlated to the growth in regulated assets, Regulated Retail Costs are closely aligned to the growth in customer numbers, Water and Electricity Costs are aligned with the number of staff. Total OPEX is also affected by materials and labour costs.

Differences in the forecasting methodology as well as disallowances from CELCOR's OPEX forecasts account for the difference in the OPEX forecasts generated by the ERC OPEX model.

In consideration of the approved adjustments on the CAPEX forecasts, ERC identified corresponding adjustments to the OPEX forecasts in the Draft Determination specifically on the Distribution Operation and Maintenance and Administrative and General expenditures. Increases in the major projects and residual growth projects correspondingly increased the OPEX forecasts while increases in the residual renewal projects correspondingly decreased the OPEX forecasts. The CPI used in the ERC OPEX model was also updated to reflect the February 2010 data as published by the EIU. The result is a net increase in the OPEX forecasts as follows:

Table 3: Comparison of Draft Determination and ERC's Forecast Operating and Maintenance Expenditure (PhP million, real 2009)

Operating and Maintenance Expenditure Category	2010	2011	2012	2013	2014	Total ¹
Distribution and Connection Services Operating and Maintenance						
Draft Determination	37.8106	38.6337	39.5455	40.2648	40.9769	197.2315
Adjusted OPEX Model	38.4111	39.5765	40.5338	41.2496	41.9584	201.7294
Difference	0.6004	0.9428	0.9884	0.9848	0.9816	4.4979
Administrative and General						
Draft Determination	27.8864	27.9462	28.0123	28.0645	28.1163	140.0257
Adjusted OPEX Model	31.3914	31.4881	31.5677	31.6273	31.6864	152.6992
Difference	3.5050	3.5420	3.5554	3.5628	3.5701	12.6735
Regulated Retail Services						
Draft Determination	37.5274	38.3061	39.8669	41.3765	42.8318	199.9088
Adjusted OPEX Model	37.5348	38.3136	39.8748	41.3847	42.8403	199.9481
Difference	0.0074	0.0075	0.0078	0.0081	0.0084	0.0393
Total Operating and Maintenance Expenditure						
Draft Determination	103.2244	104.8860	107.4246	109.7059	111.9250	537.1660
Adjusted OPEX Model	107.3373	109.3783	111.9763	114.2616	116.4851	554.3767
Difference	4.1128	4.4923	4.5517	4.5557	4.5601	17.2107
OPEX Adjustments	4.1128	4.4923	4.5517	4.5557	4.5601	17.2107

¹ It includes RY2010 plus the Second Regulatory Period which comprises a four-year regulatory period

4. TAXES, LEVIES AND DUTIES

4.1 REAL PROPERTY TAXES (APPENDIX A - ITEM 7)

In its Revenue Application, CELCOR had included real property taxes in its forecast taxes, levies and duties. In the Expenditure Report, we recommended that these be adjusted down to CY 2008 value, as taxes for which CELCOR's liability has not been confirmed, should not be included.

In its comments on the Draft Determination, CELCOR is requesting that the annual provision for real property tax should not be adjusted down to the CY 2008 value.

4.1.1 CONSTRUCTION OF BITAS COLLECTION OFFICE (APPENDIX A – ITEM 7 (A))

According to CELCOR, the construction of the Bitas Collection Office was completed last September 2009, thus, additional Real Property Tax (RPT) will be paid by CELCOR to the local government starting CY 2010 or RY 2011.

CELCOR has included an amount of PhP9,725.80 real property tax for the Bitas Collection Office and a contingency assessment of the historical value of PhP1,945.20.

Analysis

The market value for the Bitas Collection Office is PhP955 thousand. Real property taxes on this would be 2.035% of the assessed value, which is computed at 50% of the acquisition cost. Since the Bitas Collection Office has already been completed in September 2009, additional real property taxes will be paid by CELCOR to the local government commencing year 2010. In this regard, ERC made adjustments on the real property taxes amounting to PhP9,725.80 from RY2010-2014.

4.1.2 CONSTRUCTION OF DEL PILAR COLLECTION OFFICE IN 2011 AND BOARD ROOM IN 2012 (APPENDIX A – ITEM 7 (B))

Based on the comment submitted by CELCOR, additional RPT will be paid for the construction of the Del Pilar Collection Office in RY2011 and the Board Room in RY2012. CELCOR has computed an RPT of PhP48,362.94 for the Del Pilar Collection Office and an RPT of PhP26,174.08 for the Bitas Board Room.

These RPT are known and measurable expenses and are expected to be incurred, therefore CELCOR is suggesting that they be included in the annual revenue requirement.

Analysis

It has been the Commission's policy that uncertain tax liabilities should not form part of the forecast. In the event of the future imposition of additional taxes or should CELCOR become liable for taxes that are not included in the annual revenue requirement, Article XI of the RDWR allows for unexpected tax liabilities imposed during the Second Regulatory Period by means of a "Tax Event Pass Through". Considering that these structures are yet to be constructed, there is uncertainty on the additional real property taxes, thus, ERC disallowed the real property tax for Del Pilar Collection office and Bitas Board Room consistent with that approved in the Draft Determination.

4.2 RECOMMENDATION

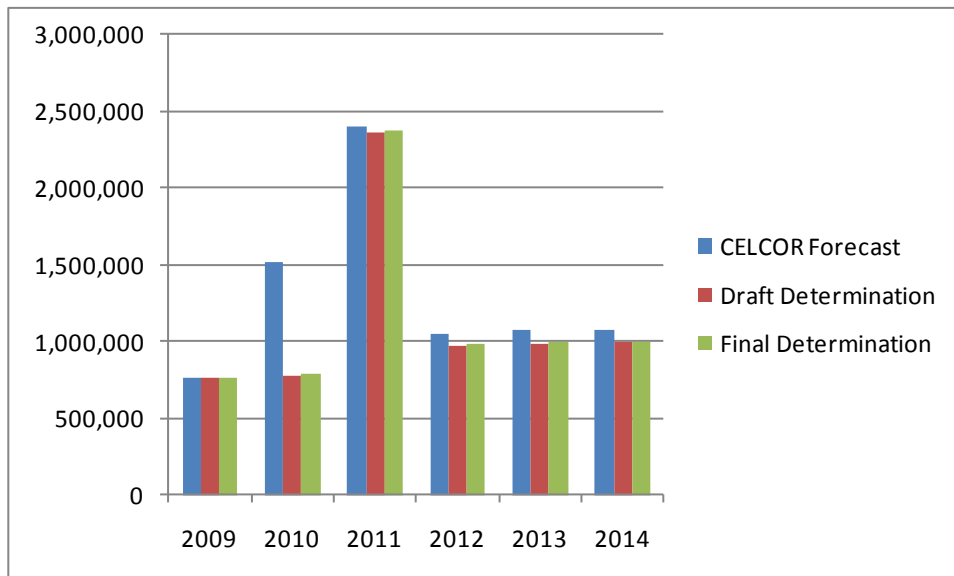
ERC's adjustments for Taxes, Levies and Duties for the Final Determination is provided in Table 4.9 below:

Table 4: Taxes, Levies and Duties (PhP million, real 2009)

Year	CY 2009	RY 2010	RY 2011	RY 2012	RY 2013	RY 2014
Proposed in CELCOR's Revenue Application						
Taxes, Levies and Duties	0.7600	1.5005	2.3235	1.0284	1.0589	1.0677
Adjustments						
Real Property Tax	0	0.0000	-0.0117	-0.0600	-0.0825	-0.0825
Regulatory Reset Expert Fees	0	-0.7368	0.0000	0.0000	0.0000	0.0000
Real Property Tax - Bitas Coll Ofc	0	0.0097	0.0097	0.0097	0.0097	0.0097
Total Adjustments	0	-0.7271	-0.0019	-0.0503	-0.0727	-0.0727
Revised Taxes, Levies and Duties	0.7600	0.7734	2.3215	0.9781	0.9862	0.9950

A graphical comparison between CELCOR's forecasts and the ERC forecast for taxes, levies and duties is shown in the figure below.

Comparison between CELCOR's Forecast and the ERC Forecast (PhP real 2009)



**APPENDIX A
SUMMARY OF COMMENTS**

Item	Page/ Section Number	Discussion of Comment/s and/or Questions for Clarification	Suggestions / Proposed Change(s)	ERC's Position
1.	DD:5.6.1 Page 30 OER: 3.3.1.1 Page 05	<p>ERC contends that additional benefits like morale booster, meal allowance, donations, employees' welfare, per diem of directors, fringe benefits, rice and electric subsidy given to CELCOR employees should not be recovered through the rates.</p> <p>ERC contends that additional benefits like morale booster, meal allowance, donations, employees' welfare, per diem of directors, fringe benefits, rice allowance and electric subsidy given to CELCOR employees should not be recovered through the customer rates.</p>	<p>CELCOR suggests that additional benefits or non-wage benefits, like morale booster, meal allowance, employees' welfare, fringe benefits, rice allowance and electric subsidy given to employees be allowed to be included in the Revenue Requirement for the following reasons:</p> <ol style="list-style-type: none"> 1. The National Wages & Productivity Commission of the Department of Labor and Employment (DOLE) issued Resolution No. 02 Series of 2008 entitled "Encouraging Employers to Grant Non-Wage Benefits to Workers". In the said Resolution, an appeal was made to the employers in the private sector and strongly encourages them to grant non-wage benefits to their workers, such as but not limited to the following: rice subsidy, transportation allowance, shuttle bus service, uniform allowance, medical and dental services, etc. 2. Other companies are offering high salaries so most of CELCOR's well-trained and competent personnel are transferring to those companies. So, in order to remain viable in a highly competitive labor market, the management decided to give the aforementioned non-wage benefits to the employees. 3. Per Diem is the only remuneration that some of the directors are receiving in performing their duties, so we request that it should be allowed to be included in the Revenue Requirement. 	<p>ERC may consider. However, it is being consistent with the Commission's directive that additional benefits given to its employees should be sourced out from its savings and not from its consumers.</p>

<p>2.</p>	<p>DD:6.4.1 Page 39</p> <p>OER:4.4 Page 19</p>	<p>REAL PROPERTY TAX</p> <p>The ERC suggest that the annual provision for real property tax be adjusted down to the CY 2008 values as CELCOR provided insufficient justification for its forecast increases.</p> <p>The annual provision for real property tax should be adjusted down to the CY 2008 value. Taxes for which CELCOR's liability has not been confirmed should not be included. In the event of future imposition of additional real property taxes or should CELCOR become liable for taxes that are not included in the annual revenue requirement, Article XI of the RDWR allows for unexpected tax liabilities imposed during the Second regulatory Period by means of a "Tax Event Pass Through"</p>	<p>CELCOR is requesting that the annual provision for real property tax should not be adjusted down to the CY 2008 value for the ff reasons:</p> <ol style="list-style-type: none"> 1. The construction of the Bitas Collection Office was completed last September 2009, hence additional Real Property Tax (RPT) will be paid by CELCOR to the local government starting CY 2010 or RY2011. 2. Other structures are to be constructed such as Del Pilar Collection Office in RY2011 and Boardroom in RY 2012. Likewise, additional RPT will be paid by CELCOR. <p>The detailed calculation of the RPT of the abovementioned real property is shown hereunder:</p> <table border="1" data-bbox="1010 544 1731 740"> <thead> <tr> <th>Structure</th> <th>Collection Office At Bitas-New</th> <th>Collection Office At Del Pilar-New</th> <th>Board Room At Bitas-New</th> </tr> </thead> <tbody> <tr> <td>Market Value</td> <td>955,852.67</td> <td>3,960,928.69</td> <td>1,837,422.19</td> </tr> <tr> <td>Assess Level</td> <td>50%</td> <td>60%</td> <td>70%</td> </tr> <tr> <td>Tax Rate</td> <td>2.035%</td> <td>2.035%</td> <td>2.035%</td> </tr> <tr> <td>RealProp.Tax</td> <td>9,725.80</td> <td>48,362.94</td> <td>26,174.08</td> </tr> </tbody> </table> <p>The Assessment Level for Commercial Buildings is based on Cabanatuan City Resolution No.411-2005/Ordinance No.2005-074 page 32. The current Basic RPT Rate is 1.125% ; Special Education Fund (SEF) RPT is 0.9% ; and Fire Tax on Commercial Building is .01% or total of 2.035%</p> <p>These PRT are known and measurable expenses and are expected to be incurred, therefore we suggest that they be included in the annual revenue requirement.</p>	Structure	Collection Office At Bitas-New	Collection Office At Del Pilar-New	Board Room At Bitas-New	Market Value	955,852.67	3,960,928.69	1,837,422.19	Assess Level	50%	60%	70%	Tax Rate	2.035%	2.035%	2.035%	RealProp.Tax	9,725.80	48,362.94	26,174.08	<p>ERC may consider subject to the submitted supporting documents.</p>
Structure	Collection Office At Bitas-New	Collection Office At Del Pilar-New	Board Room At Bitas-New																					
Market Value	955,852.67	3,960,928.69	1,837,422.19																					
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