

1 REPUBLIC OF THE PHILIPPINES)
2 CITY OF CAGAYAN DE ORO) S.S.

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4

5 **A F F I D A V I T**

6

7 I, CHIQUITA C. CAPILI, of legal age, Filipino, married, a resident of Apovel
8 Subdivision, Bulua, Cagayan de Oro City, and an employee of Cagayan Electric
9 Power and Light Co., Inc. (also "CEPALCO" for brevity), after having been duly
10 sworn in accordance with law, do hereby depose and declare as follows:

11

12 1. How long have you been employed with CEPALCO?

13

14 I have been employed with CEPALCO for 19 years.

15

16 2. What is your current position in the company?

17

18 I am currently designated as Vice President - Controller.

19

20 3. As Controller, what are your functions?

21

22 I take responsibility in giving general guidance and direct supervision in
23 carrying out the functions that mainly cover: a) Budgeting and Financial
24 Planning, b) Rates Studies and Energy Contracts Administration, and c)
25 Management Support Services.

26

27 4. How long have you been working on CEPALCO's rate matters?

28

1 I have been working on CEPALCO's rates matters for more than 15
2 years.

3

4 5. Aside from your function as the Controller, what other functions or
5 positions do you hold?

6

7 I am a member of the Management Committee (MANCOM), the
8 chairperson of the Rates Committee and the Budget Committee, and a
9 member of the Energy Contracts Committee.

10

11 6. What are the functions of this Management Committee?

12

13 The Management Committee (MANCOM) is a committee composed of
14 Division Heads and key Department Heads representing a cross-section
15 of the Company's key functions. This committee is primarily an advisory
16 to the President and Chief Operating Officer on matters relating to policy
17 directions, operations, corporate concerns, and vital issues affecting the
18 company.

19

20 7. As a member of the Management Committee, what are your
21 responsibilities and involvement in company operations or
22 management?

23

24 As a member of MANCOM, I am actively involved in the deliberations
25 and making decision on major issues affecting the company. This
26 includes formulation of corporate goals and objectives, policy directions,
27 and deliberations in coming up with recommendations for management
28 action that ensures integrity and coherence in operations management,
29 and other corporate concerns affecting the company.

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8. As Chair of the Rates Committee, what are your responsibilities and involvement in company operations or management?

As chairperson of the Rates Committee, which is composed of specialists, I am responsible for providing general guidance and direct supervision in the conduct of rates-related studies, rate revision applications, cost of service studies, and making recommendations to higher management on appropriate actions to be taken. The committee takes responsibility in conducting regular cost of service evaluation to ensure that the rates to consumers and the charges imposed by power suppliers are accurate, fair, and reasonable.

9. As chairperson of the Budget Committee, what are your responsibilities and involvement in company operations or management?

As Chair of the Budget Committee, I take responsibility in ensuring that the annual operating and capital budgets are prepared and implemented by respective proponents in accordance with the corporate goals and operational objectives, and that the consolidated operating, capital, and cash budgets are endorsed and approved for implementation by Top Management will ensure financial integrity and stability of the company.

10. As Member of the Energy Contracts Committee, what are your responsibilities and involvement in company operations or management?

As member of the Energy Contracts Committee, I am actively involved in making evaluation and recommendation for Management's action to

1 ensure reliable and least-cost power supply contracting with all power
2 suppliers.

3
4 11. Why is CEPALCO filing this application?

5
6 CEPALCO is filling this application as part of the regulatory reset
7 process required prior to start of the second regulatory period. The reset
8 process is undertaken by CEPALCO as one of the pioneering entrants to
9 the Performance Based Regulation (PBR) in accordance with the ERC-
10 approved Distribution Wheeling Rates Guidelines (DWRG) as
11 subsequently amended in the Rules for Setting Distribution Wheeling
12 Rates (RDWR). Upon ERC's approval, this application shall serve as
13 the basis for ERC in setting the price cap that shall apply during the
14 second regulatory period covering the regulatory years 2008 to 2011.

15
16 12. What is your involvement in the preparation of this application?

17
18 I am the over-all coordinator of the entire regulatory rate reset project
19 that includes the preparation of this application. As such, with the
20 support of MANCOM and top management, I conceptualized the project
21 direction, activities, and timelines; conducted PBR-workshops and
22 briefings to all employees involved in the project; organized PBR-
23 working committees; coordinated with the activities and the consolidation
24 of the outputs of all working committees; directly supervised the
25 integration of all the input data and its subsequent processing up to
26 packaging this application.

1 13. At the last page of the Application which is captioned
2 Verification/Certification, there is a signature above the name
3 "CONSUELO G. TION", do you know whose signature is this?
4

5 Yes. It is the signature of Mrs. Consuelo G. Tion.
6

7 14. Why do you know that this is her signature?
8

9 I am very familiar of her signature because I have been reporting to her
10 as my direct superior for almost 10 years.
11

12 15. What is your company seeking approval in this application for?
13

14 We are seeking approval for: 1) the Annual Revenue Requirement; 2)
15 Performance Incentive Scheme; and, 3) the Procedure to convert the
16 Maximum Average Price into rates for each customer class, for the
17 second regulatory period covering the regulatory years 2008 to 2011.
18

19 16. In the caption of your application, it is stated that these three items are
20 all in accordance with the provision of the Rules for Setting Distribution
21 Wheeling Rates. Why is this so?
22

23 The entire application is packaged in accordance with the ERC-
24 approved Distribution Wheeling Rates Guidelines (DWRG) as amended
25 in the Rules for Setting Distribution Wheeling Rates (RDWR) because all
26 the items in the application are prepared in accordance with the
27 methodology, procedures, and formula prescribed in the said guidelines
28 and its related issuances,
29

1 17. Being involved in this Application, what other rules or issuances are
2 relevant to this Performance Base Rate Setting Methodology?

3
4 Other ERC-issuances relevant to preparation of this application include
5 the following: **a)** Regulatory Reset Position Paper for the second
6 regulatory paper dated December 9, 2005 and its addendum dated
7 March 22, 2006; **b)** Preliminary Calculation of the Regulatory Weighted
8 Average Cost of Capital for the second regulatory period; **c)** Preliminary
9 Calculation of the Construction Work-in-progress Factor; **d)** Asset
10 Valuation Policy Guidelines, and **e)** Standard Asset Lives for Philippine
11 Distribution Utilities.

12
13 18. Have you attended trainings, seminars and other conferences related to
14 these rules?

15
16 I have attended various trainings that generally cover the areas in: Rates
17 Planning, Analysis and Design; Demand-side Management; and
18 Economic Management of Power Utilities. These trainings include
19 principles and practices relevant to the formulation of rules on setting
20 distribution wheeling rates as well as the actual planning, design and
21 implementation of distribution wheeling rates under Performance-based
22 Regulation.

23
24 I also have active involvement in seminars, workshops, conferences, and
25 various public consultations conducted by ERC on various regulatory
26 issues, which include its promulgation of the rules and guidelines and its
27 related issuances relevant to the adoption of this Performance-based
28 Regulation as an internationally-accepted alternative form of rate-setting
29 methodology pursuant to Section 43 (f) of the Republic Act No. 9136.

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19. What is this Annual Revenue Requirement?

The Annual Revenue Requirement (ARR) refers to the total yearly amount necessary to compensate the distribution utility for the efficient and reasonable costs it incurs in providing distribution services to its customers. In accordance with the ERC-approved rules, the ARR is composed of five building blocks. These are: 1) Operating and Maintenance Expenses, 2) Other Taxes, 3) Depreciation, 4) Cost of Capital, and 5) Corporate Income Tax.

20. What is this Maximum Annual Price?

The Maximum Annual Price (MAP) refers to the average distribution wheeling charge for all customers in a year. The serves as the price cap, which means that the average of distribution charges for all customers in a year should not exceed the price cap or the MAP.

21. How does the Maximum Annual Price set for each year?

The MAP for each regulatory year is determined in accordance with the pricing formula prescribed in the ERC-approved guidelines.

22. What about this Performance Incentive Scheme?

The Performance Incentive Scheme (PIS) is a scheme that requires CEPALCO to set system and service performance targets and guaranteed customer service thresholds. Then, based on the set performance targets and service thresholds, the scheme provides a

1 mechanism that penalizes CEPALCO if its actual performance falls
2 below targets and gives incentives if its actual performance exceeds
3 targets.

4
5 The PIS is the main focus of this alternative form of rate-setting
6 methodology because it motivates distribution utilities to exceed service
7 performance and efficiency target levels. This mechanism will result to
8 improvement in service levels while assuring efficient operations to keep
9 the costs fair and reasonable to all stakeholders.

10
11 The entire scheme will ultimately redound to the benefits of the
12 customers by enjoying a more efficient and reliable service at
13 reasonable rates.

14
15 23. What about these procedures to convert the Maximum Average Price
16 into rates?

17
18 The MAP or the price cap that shall be established based on the price
19 control formula prescribed in the guidelines is an average of the
20 distribution charges for all customers in a regulatory year. The
21 procedures to convert the MAP into rates as described in the application
22 outlines the steps that to be followed to translate the MAP which is an
23 average for all customer classes into charges or rates for each customer
24 class that shall be the basis for the monthly billings.

25
26 24. What is this Maximum Average Price?

27
28 The Maximum Average Price (MAP) is similar to the Maximum Annual
29 Price. It refers to the average distribution wheeling charge for all

1 customers that also serves as the price cap. This means that the actual
2 average distribution charges for all customers in a year should not
3 exceed the price cap or the MAP.
4

5 25. Going back to the Annual Revenue Requirement, do you have figures to
6 show how much are these “building blocks”?
7

8 Yes. These figures are indicated in Table 1, page 3 of the application.
9

10 26. In Par. 5 of the Application it is stated that the aforementioned Annual
11 Revenue Requirement is based on a proposed rolled-forward value of
12 the applicant’s regulatory asset base. What is meant by “rolled-forward”
13 values?
14

15 Rolled—forward values of the regulatory asset base refer to the value of
16 assets at the end of the regulatory year. It is arrived at starting from the
17 value of assets at the start of the year called the opening regulatory
18 asset base or Opening RAB. Then, the capital expenditure for the year
19 is added to the Opening RAB while the regulatory depreciation for the
20 same year is deducted from the Opening RAB.
21

22 To present a simplified illustration, the rolled-forward value of RAB at
23 end of each regulatory year is analogous to one’s bank account balance
24 at the end of a year. It starts with the beginning bank balance at the
25 start of the year, then the deposits made during the year are added to
26 the beginning balance while the withdrawals during the year is deducted
27 from the beginning balance to arrive at the rolled-forward ending bank
28 balance.
29

1 27. What is the importance of the regulatory asset base to your Annual
2 Revenue Requirement?

3
4 The Regulatory Asset Base (RAB) represents the optimized value of the
5 assets used in providing distribution services. As such, it is the bases
6 for the two major components of the ARR, which are the Depreciation
7 Expense and the Cost of Capital.

8
9 28. How much are your proposed rolled-forward regulatory asset base for
10 each year?

11
12 The proposed rolled-forward regulatory asset base (RAB) for the
13 regulatory years 2008 to 2011 is shown in Table 2 or paragraph 5 in
14 page 3 of the application.

15
16 29. How is the rolled-forward regulatory asset base obtained?

17
18 As shown in Table 2 under paragraph 5 of the application, the rolled-
19 forward values starts with an opening RAB for 2008 of P2,475,465,434.
20 Then, in each year, the capital expenditure forecast is added to and the
21 depreciation is deducted from the opening RAB to arrive at the closing
22 RAB for the year. Lastly, the opening RAB and the closing RAB for the
23 year are added together and then divided by two to get the Average RAB
24 for the same year.

25
26 30. How is the opening Regulatory Asset Base arrived at?

27
28 The opening regulatory asset base (RAB) for the second regulatory
29 period is arrived at by computing for the rolled-forward values of assets

1 as at end of the first regulatory period or as of June 2007. The rolled-
2 forward values of the opening RAB starts with the initial RAB which
3 refers to the values of assets installed as of April 2006 as at June 2006.

4
5 The initial RAB approved by ERC is based on the report of the
6 independent asset valuation expert hired in accordance with the
7 guidelines.

8
9 Then, the actual and projected capital additions for May 2006 to June
10 2007 are added to, while the depreciation of all assets including
11 retirements as of June 2007 is deducted from the initial RAB to arrived at
12 the Opening RAB for the second regulatory period.

13
14 31. How do you treat those assets which are still used and are beyond their
15 standard lives?

16
17 In accordance with the RDWR, for those assets that are beyond there
18 standard lives but still remain useful in a year, an allowance is provided
19 at 5% of their optimized replacement cost.

20
21 32. In Paragraph 7 of your application, it mentioned some preliminary values
22 for the parameters stated, and listed in Table 3 under the same
23 paragraph. What are these for?

24
25 Table 3 under paragraph 7 of the application shows a table for the
26 preliminary input values provided or set by ERC for the parameters listed
27 in the table. These are:

28 a. Construction-work in progress (CWIP) factor. This factor is
29 necessary to compensate the utility for the inherent costs of the

1 funds tied up with the project during construction until
2 commissioning of the project. The preliminary values for the
3 CWIP factor are 4.5% for substation projects and 3.2% for all the
4 other capital projects.

5 b. P_0 - factor is an amount in PhP/kWh that the ERC will set. This
6 factor is intended to avoid price shocks during the transition from
7 the first regulatory period (covering July 2005 – June 2007) to the
8 second regulatory period (covering July 2007 – June 2011). The
9 preliminary value provided by ERC to be used for this application
10 is zero.

11 c. X- factor is an efficiency factor to be calculated based on the
12 Annual Revenue Requirement using the prescribed formula in the
13 RDWR. The preliminary value provided by ERC for this
14 application is zero.

15 d. Valuation as at June 30, 2006 of existing assets installed as of
16 April 30, 2006. This is provided by ERC at PhP 1,945,938,961.
17 This valuation is based on the report of an independent asset
18 valuation expert hired in accordance with the guidelines.

19 e. Working Capital - this is a provision for the working funds
20 necessary to operate the distribution system. This includes
21 working fund for: **a)** operating and maintenance (O&M) expenses
22 equivalent to 1/6 of the total O&M for the year, and **b)** purchased
23 power equivalent to 8/360 of the total cost of purchased power for
24 the year.

25
26 33. How is the Construction Work-in Progress Factor determined?
27

28 In Section 4.1.10 of the Regulatory Reset Position Paper dated
29 December 7, 2006, the ERC indicated that it shall apply a general CWIP

1 Factor for all assets which may be applied to a particular asset category.
2 As guide for this application, ERC issued a paper entitled Preliminary
3 Calculation of the Construction Work-in Progress Factor that will apply
4 for the second regulatory Period dated August 28, 2006.

5
6 The CWIP Factor paper was prepared by ERC's RDWR Team with the
7 support by the reset expert. Prior to issuance of such paper, the ERC
8 RDWR Team requested relevant data/information and solicited
9 comments from the three PBR-entrant utilities, namely: MERALCO,
10 Dagupan Electric Corp., and CEPALCO.

11
12 For this application, the indicative CWIP Factors provided in the paper at
13 4.5% for Substation projects and 3.2% for other projects are adopted.
14 Such preliminary values were accepted as reasonable and used in this
15 application because the resulting factors are set based on the data and
16 information that represent the prevailing project construction condition
17 and duration for distribution utilities in Philippines.

18
19 34. In Paragraph 8 of the Application, it mentioned that your company made
20 use of Philippine, U.S. Consumer Price Indices and Philippine Peso/U.S.
21 Dollar Exchange Rate. How are these used?

22
23 The consumer price indices are used to convert the capital and
24 operating expenditures forecasts from real values to nominal values.
25 The conversion is necessary to impute price increases or inflation in the
26 operating and capital expenditures forecasts.

27
28 On the other hand, the Philippine Peso-to-US Dollar Exchange Rate is
29 used to covert the items purchased in US Dollars into real peso values.

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35. What are your sources of these data?

These data are taken from the indices used in the rate reset of TRANSCO as approved by the ERC under ERC Case No. 2005 – 041RC.

36. Do you have documents to prove this?

Yes. These are shown in Schedule B of the application.

37. In Paragraph 8a of the Application, it is stated that for the initial and subsequent annual price resets during the second regulatory period, these consumer price indices and foreign exchange rates shown in Table 3a, 3b, and 3c will be updated with actual values and that such actual values will be used for the price resets. Why is this so?

So that the price resets done for each year are computed using the actual values of these indices.

38. What do you mean by price resets?

Annual price resets refer to the setting of the price cap that shall apply for each regulatory year 2009, 2010, and 2011. The annual price reset shall be done in accordance with the price control formula prescribed in the guidelines.

1 The price cap and specific rates for each customer class for 2008 is
2 determined as part of the final determination in this rate application
3 which is scheduled to be issued by ERC before July 2007.

4

5 39. In the Application, it is proposed by CEPALCO that the Annual Revenue
6 Requirement includes a proposed return on capital at a rate of 16.85%.
7 What is this proposed rate of return for?

8

9 The rate of return proposed at 16.85 is necessary to compensate
10 CEPALCO for the cost of capital it incurs for the investments in the
11 distribution system. This basically covers for the interest expense on
12 borrowed capital and the reasonable return for the capital contributed by
13 the equity holders.

14

15 40. What is Weighted Average Cost of Capital?

16

17 It refers to the cost of capital weighted according to source, namely: debt
18 for the borrowed capital and equity for the capital contributed by the
19 owners. In accordance with the guidelines, the capital ratio is pegged at
20 45% debt and 55% equity.

21

22 41. How is the preliminary value of WACC at 16.85% arrived at?

23

24 Section 4.3 of the Regulatory Reset Position Paper indicates that in the
25 first quarter of 2006, the ERC will appoint a regulatory reset expert to
26 investigate the regulatory WACC that should apply to distribution utilities
27 in the Philippines. The paper outlines the methodology, procedures,
28 formula to be followed in arriving at the regulatory WACC.

29

1 Prior to ERC's issuance of the WACC paper, the reset expert and ERC
2 conducted consultation with the PBR-entrant utilities including other
3 parties interested on the subject. In view of the consultation process
4 made by ERC and the reset expert, we believed that the final WACC
5 paper issued by ERC takes into consideration the capital market
6 conditions for distribution utilities in the Philippines. Hence, the same is
7 adopted and followed in arriving at the preliminary value of WACC
8 computed at 16.85% and such value is used in this application.

9
10 42. Why do you say that the proposed rate of return should be 16.85%?

11
12 The 16.85% rate of return was calculated using the methodology
13 indicated in the paper issued by ERC entitled Preliminary Calculation of
14 the Regulatory Weighted Average Cost of Capital that will apply during
15 the Second Regulatory Period.

16
17 A rate of return based on the prevailing WACC that takes into account
18 the cost of debt and cost of equity under current market conditions is the
19 most fair and reasonable basis for the rate of return.

20
21 However, it is recognized that the ERC will ultimately determine the
22 regulatory WACC that will apply for all PBR-entrant distribution utilities in
23 its setting the Maximum Average Price (MAP).

24
25 43. How will these Annual Revenue Requirement and Performance
26 Incentive Scheme relate to the rates of the electric bills you will charge
27 to your customers?
28

1 The Annual Revenue Requirement (ARR) and the Performance
2 Incentive Scheme submitted for approval in this application shall serve
3 as the bases for ERC in setting the Maximum Average Price (MAP) that
4 shall apply for the regulatory years 2008 – 2011. The MAP that shall be
5 set for each year in accordance with the price control formula prescribed
6 in the guidelines, shall then be converted or translated into specific rates
7 for each customer class.

8
9 **1st Building Block: Operating and Maintenance Expenditures**

10
11 44. On Operating and Maintenance (also O & M for brevity) Expenditure
12 which is the first building block of the ARR, the Application in Paragraph
13 11 presented figures as shown in Table 5, how are these figures
14 obtained?

15
16 The figures in Table 5 under paragraph 11 of the application are a
17 summation of the forecasted operating expense requirements for each
18 operating departments or units for the years 2007 – 2011.

19
20 45. How is the forecast made?

21
22 The preparation of the operating expense forecast was done after a
23 series of planning sessions which include the following process:

- 24 a. formulation of the corporate goals and objectives by MANCOM
25 together with managerials of each operating unit;
26 b. identification of projects and action plans that should be undertaken
27 to achieve the corporate objectives;
28 c. quantification of the resources required;

- 1 d. consolidation of the operating requirements submitted by each
2 proponent;
3 e. deliberation and concurrence of the consolidated forecast by the
4 Management Committee.

5

- 6 46. In Paragraph 11a of the application, it is stated that the proposed O&M
7 expenditures will be increased by 5% each year due to projected
8 inflation during the period. Why is this?

9

10 The projected annual increase in the prices of items used in the
11 distribution operation, or generally know as inflation, for the period 2007
12 to 2011 results to an increase in the O&M expenditures forecast from
13 current levels by an annual average of 5%.

14

- 15 47. What is your basis in saying it will be 5%?

16

17 The 5% is the resulting average annual increase in O&M forecast for
18 2007 – 2011 based on the projected Philippine and US Consumer Price
19 Index (CPI) adopted in the application. These indices are taken from the
20 indices used in the rate reset of TRANSCO as approved by the ERC
21 under ERC Case No. 2005 – 041RC.

22

- 23 48. Do you have a document to prove this?

24

25 As mentioned earlier, the details on how these indices were derived are
26 shown in Schedule B of the application.

27

28 **2nd Building Block : Taxes, Duties and Levies**

29

1 49. In Paragraph 12 of the Application, the proposed Taxes, Levies and
 2 Duties are shown in Table 6. How are the figures stated therein
 3 computed?
 4

5 The figures shown in Table 6 under paragraph 12 of the application are
 6 computed based on prevailing rates for real and property taxes, duties
 7 and levies. The levies mainly include fees for the supervisory and
 8 regulatory services of the ERC, and fees for the consultants or
 9 regulatory reset experts that shall be hired in accordance with the
 10 guidelines.
 11

12 However, the figures in Table 6 of the application also include a
 13 provision for local franchise tax. At this point, I would like to point out an
 14 unintentional inclusion of local franchise tax under Levies, Duties and
 15 Taxes. Under the ERC-approved guidelines, local franchise tax, being a
 16 passed-through item, are not to be recovered under the distribution
 17 wheeling rates, hence, should not be included. To correct the error, the
 18 amount pertaining to local franchise tax will have to be taken out from
 19 the figures in Table 6.
 20

21 The table below shows the corrected Taxes, Levies and Duties. These
 22 figures already exclude franchise tax. Correspondingly, the taxes that
 23 form part of the building blocks of the ARR should also be corrected to
 24 exclude franchise tax.
 25

	Nominal PhP				
	2007	2008	2009	2010	2011
Taxes, levies & duties (nominal PhP)	31,260,381	37,740,761	37,363,465	44,873,908	47,215,838
Less:					
Franchise Tax(FT)	29,810,191	33,554,015	35,784,722	40,356,025	45,068,576
Taxes, levies & duties (Excluding FT)	1,450,190	4,186,746	1,578,743	4,517,883	2,147,262

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3rd Building Block : Regulatory Depreciation

50. On Regulatory Depreciation, the figures for these are stated in Table 1, found in Paragraph 3 of the Application (page 3), how did you arrive at these figures?

The regulatory depreciation is arrived at in accordance with the methodology and formula prescribed in the guidelines. It basically uses the straight-line method of calculating depreciation using the standard asset lives for Philippine distribution utilities approved by ERC. Simply stated, annual regulatory depreciation is computed by dividing the cost of the asset by its standard life.

51. It is mentioned in Paragraph 13a of the Application that the depreciation is calculated on a straight line basis, based on the standard asset lives approved by the ERC. Do you have a document to show these standard asset lives?

The standard asset lives used to calculate the regulatory depreciation for this application is based on the ERC-approved standard asset lives for Philippine distribution utilities as recommended by the independent expert on asset valuation who were hired for this reset process in accordance with the ERC-approved guidelines. This is indicated in the report on the Standard Asset Lives for Philippine Distribution Utilities submitted to

1 ERC by the independent reset expert on asset valuation.

2

3 **4th Building Block: Return on Capital**

4

5 52. On Return on Capital as stated in Table 1, Paragraph 3 of the
6 Application (page 3), how are the amounts derived?

7

8 The return on capital is computed by multiplying the rate of return by the
9 average regulatory asset base (RAB) including the provision for working
10 capital for each year. The return on capital as explained earlier is based
11 on the preliminary value for Weighted Average Cost of Capital (WACC)
12 at 16.85%.

13

14 **5th Building Block: Corporate Income Tax**

15

16 53. How is your corporate income tax figures derived?

17

18 The forecast for corporate income tax is computed by multiplying 35% of
19 the forecasted net taxable income for the regulatory years 2007 – 2011.

20

21 54. Table 11 under paragraph 17 of the application shows that there is an
22 increase in the rates for residential and small commercial customers,
23 why is this so?

24

25 At the outset, let me emphasize that the figures presented in Table 11
26 are for illustration purposes only and should not in any way be construed
27 as the results of this application.

28

1 As illustrated in Table 11, the resulting increases in the rates of
2 residential and commercial customers in Regulatory Year 2008 were
3 mainly due to the removal of inter-class cross subsidies amounting to
4 P0.2650/kWh and P0.1960/kWh for residential and commercial
5 customers, respectively. The said removal of subsidies will take effect
6 starting the December 2006 billing period of CEPALCO. This is the third
7 and final phase of the cross-subsidy removal scheme as approved by
8 the ERC in compliance with Section 74 of R.A. 9136.

9
10 The increases in rates in the succeeding Regulatory Years are mainly
11 due to the estimated increase in the initial Maximum Average Price as
12 presented in Table 10.

13
14 55. Also, why is there is a slight decrease for big industrial and bulk 69-KV,
15 138 KV power customers?

16
17 The slight decrease in the rates for Big Industrial and Bulk Power
18 customers in Regulatory Year 2008 were also due to the removal of
19 inter-class cross subsidies.

20
21 The increases in the subsequent Regulatory Years are due to the
22 estimated increase in the initial Maximum Average Price as presented in
23 Table 10.

24
25 56. Your company's application also seeks approval for the adoption of a
26 Performance Incentive Scheme, what is this about?

27
28 As mentioned earlier, the Performance Incentive Scheme (PIS) is a
29 scheme that requires CEPALCO to set performance targets. In this

1 application, CEPALCO seeks approval by ERC for the proposed system
2 and service performance targets and the guaranteed customer service
3 thresholds.

4
5 The approved performance targets and guaranteed customer service
6 thresholds shall serve as the basis for penalizing CEPALCO if its actual
7 performance falls below targets or giving incentives if actual
8 performance exceeds targets.

9
10 As required in the ERC-approved guidelines, there are two schemes,
11 namely: a) Price-linked Performance Incentive Scheme (PIS), and b)
12 Guaranteed Service Level (GSL).

13

14 57. What is Price-linked Performance Incentive Scheme?

15

16 Price-linked PIS is a scheme wherein the reward or penalty for each
17 year, as a result of CEPALCO's actual performance compared to the
18 approved targets, will be directly incorporated into the price cap or the
19 Maximum Average Price (MAP) for the following year during the Second
20 Regulatory Period.

21

22 58. What are your proposals for these?

23

24 The proposed targets under the Price-linked PIS are shown in Table 12
25 under paragraph 18 in page 16 of the application.

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27 59. How about this Guaranteed Service Level Performance Incentive
28 Scheme?

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The Guaranteed Service Level (GSL) is a scheme wherein the customers will be directly compensated by CEPALCO if actual customer service levels falls below the guaranteed service thresholds.

60. What are your proposals under the GSL Scheme?

The proposed customer service thresholds under the GSL Scheme are shown in Table 13 under paragraph 19 in page 16 of the application.

61. In Paragraph 19a of the Application, it is stated that the applicant will be entitled to an additional revenue amount equal to 0.5% of the Annual Revenue Requirement, which is intended to be applied to the Guaranteed Service Level Scheme, and can be used to either provide for penalties under the scheme, or for network or operational improvements to avoid such penalties. What is the basis for this 0.5% additional revenue?

The 0.5% additional revenue for the GSL Scheme is in accordance with the provisions of the ERC-approved guidelines and its related issuances, specifically under Section 9 of ERC's Regulatory Reset Position Paper dated December 7, 2005 and the Framework for the Performance Incentive Scheme dated March 1, 2006.

62. You earlier said that your proposed Performance Incentive Scheme is in accordance with the provisions of the Rules for Setting Distribution Wheeling Rates, why do say so?

1 Because the entire proposal is developed in accordance with the
2 methodology and procedures prescribed in the ERC-approved
3 guidelines and its related issuances.

4
5 63. You earlier said that your proposed Annual Revenue Requirement is in
6 accordance with the provisions of the Rules for Setting Distribution
7 Wheeling Rates, why do say so?

8
9 The proposed Annual Revenue Requirement (ARR) is in accordance
10 with the provisions of the Rules for Setting Distribution Wheeling Rates
11 and its related ERC-issuances because each component of the 5
12 building blocks of ARR is arrived at using the methodology and formulas
13 prescribed in the ERC-approved guidelines and its relat4ed issuances.

14
15 The five building blocks of ARR, as earlier mentioned, are: 1) Operating
16 and Maintenance Expenses, 2) Depreciation, 3) Other Taxes, 4) Cost of
17 Capital, and 5) Corporate Income Tax. These five components of the
18 ARR were calculated and arrived at in accordance with rules and
19 guidelines provided in the DWRG as amended under the Rules for
20 Setting Distribution Wheeling Rates (RDWR) and the various related
21 ERC-issuances that I earlier enumerated above.

22
23 64. In Paragraph 22 of the Application it is stated that there are attached
24 required documents as listed in Table 14 thereof, in support of the
25 application and as described in the RDWR and Position Paper. What is
26 your involvement in the preparation of these attached documents?

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28 I provided general guidance and direct supervision in the preparation of
29 all the supporting documents listed in Table 14 of the application.

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65. Do you confirm the truthfulness of the information as contained in these attached documents?

Yes, I confirm the truthfulness of the information as contained in the documents listed in Table 14 under paragraph 22 of the application, except for the secondary data that were taken from outside but reliable sources as indicated.

66. In summary, why do you seek approval of this application?

We respectfully seek the approval of this application because with ERC's approval of the Annual Revenue Requirements as applied, it will enable CEPALCO to carry its obligations for operating and maintaining the electricity distribution system to provide efficient and reliable distribution services at reasonable costs.

Otherwise, CEPALCO and ultimately the public it serves stand to suffer great and irreparable prejudice because CEPALCO will not be able to undertake the necessary projects to sustain the maintenance of safe, reliable, and efficient distribution system and facilities.

Further, approval of the proposed Performance Incentive Scheme will also provide a mechanism that will motivate CEPALCO to improve its services by instituting a penalty scheme if its actual performance falls below targets or grants reward if performance exceeds the targets. This scheme if approved will ultimately redound to the benefits of its customers.

1 Lastly, approval of the procedures to convert the price cap or the
2 Maximum Average Price (MAP) into specific rates for each customer
3 class will ensure that the specific customer charges are designed and
4 appropriately set to reflect the proportionate cost of service for each
5 customer class.

6

7 IN WITNESS WHEREOF, I have hereunto affixed my signature this 23rd
8 day of September 2006, in Cagayan de Oro City.

9

10

CHIQUITA C. CAPILI

11

Affiant

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SUBSCRIBED AND SWORN TO before me this 23rd day of September
2006, in Cagayan de Oro City, affiant exhibited to me her Community Tax
Certificate No. 14473472 issued on January 17, 2006 in Cagayan de Oro City.

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Isidro O. Baculio Jr.

Notary Public

PTR No. 8691822 12/16/05

At Cagayan de Oro City

IBP No. 828925 12/13/05

Misamis Oriental Chapter

TIN: 136-332-993

Roll No. 38265

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Page No. 37;

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Book No. XXI;

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Series of 2006.