

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



**IN THE MATTER OF THE
APPLICATION FOR APPROVAL OF
RATE ADJUSTMENT IN
ACCORDANCE WITH R.A. 9136,
WITH PRAYER FOR PROVISIONAL
AUTHORITY**

ERC CASE NO. 2007- 042 RC

**CAGAYAN I ELECTRIC
COOPERATIVE, INC. (CAGELCO I),
Applicant,**

x-----x

D O C K E T E D
Date: **FEB 13 2008**
By: _____

DECISION

Before the Commission for resolution is the application filed by Cagayan I Electric Cooperative, Inc. (CAGELCO I) on February 19, 2007 for approval of its rate adjustment in accordance with R.A. 9136, with prayer for provisional authority.

Having found the said application sufficient in form and in substance with the required fees having been paid, an Order and a Notice of Public Hearing, both dated April 2, 2007, were issued setting the same for jurisdictional hearing, pre-trial conference and evidentiary hearing on April 27, 2007 and May 7, 2007 at CAGELCO I, Maddarlug, Solana Cagayan and at the ERC Hearing Room.

In the same Order, CAGELCO I was directed to publish 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 Philippines, with the date of the last publication to be made not later than ten (10) days before the scheduled date of initial hearing. It was also directed to inform the consumers within its franchise

area by any other means available and appropriate, of the filing of the instant application, its reasons therefor, and of the scheduled hearing thereon.

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 Offices of the Mayors of the City/Municipalities within the franchise area of CAGELCO I were furnished with copies of the Order and the Notice of Public Hearing for the appropriate posting thereof on their respective bulletin boards.

During the April 27, 2007 initial hearing hereof, only CAGELCO I appeared. No oppositor/intervenor appeared nor was there any opposition/intervention registered. At the said hearing, CAGELCO I submitted its proofs of compliance with the Commission's publication and posting of notice requirements which were duly marked as Exhibits "A" to "I", inclusive. Thereafter, it conducted an expository presentation of its application.

At the continuation of the hearing on May 7, 2007, CAGELCO I presented its witness, Ms. Rosalinda C. Binarao, its Accounting and Finance Services Department Manager, who testified in support of the application. At the termination of the direct examination, the Commission propounded clarificatory questions on the said witness. Thereafter, the Commission directed CAGELCO I to submit various documents relative to its application.

During the hearing on May 16, 2007, the Commission further asked clarificatory questions on the witness. CAGELCO I then submitted the required documents and made an oral formal offer of evidence which was admitted for being relevant and material in the resolution of the case.

DISCUSSION

Proposed Revenue Requirement Based on Test Year 2005

On the basis of its Audited Financial Statement (AFS) for the year 2005 using the Cash Base Methodology under the Uniform Filing Requirements (UFR), CAGELCO I proposed a revenue requirement of PhP205,801,021.00.

Shown below is the detailed computation of its proposed revenue requirement:

ACCOUNT NAME	Per Application (PhP)	Adjustments (PhP)	Per Adjusted Application (PhP)
Payroll	37,055,636	1,494,854	38,550,490
Operation & Maintenance (less Purchase Power & Payroll)	45,641,651	4,150,529	49,792,180
Debt Service	24,452,262	-	24,452,262
Cost of Cash Working Allowance	7,145,605	-	7,145,605
Less: Other Revenue Items (ORI)	(219,939)	-	(219,939)
Add: Reinvestment Fund	86,080,423	-	86,080,423
Total Revenue Requirement	200,155,638	5,645,383	205,801,021

Comparison of Proposed and Existing Rates

CAGELCO I provided the estimated impact of its proposed rates on different customer classes, as follows:

CUSTOMER CLASS		Proposed Rates	Existing Rates	Difference
Residential				
Distribution	PhP/kWh	1.7008	0.6628	1.0380
Supply	PhP/kWh	0.6683	0.3164	0.3519
Metering	PhP/kWh	0.2230	0.1509	0.0721
Metering	PhP/Meter/Mo	5.00	5.00	0
Loan Condo	PhP/kWh	0.00	(0.1831)	0.1831
Commercial				
Distribution	PhP/kWh	0.3020	0.3669	0.4360
Supply	PhP/Cust/Mo	44.61	24.58	20.03
Metering	PhP/kWh	0	0.4489	(0.4489)
	PhP/Meter/Mo	19.89	20.25	(0.3623)
Loan Condo	PhP/kWh	0	(0.0438)	0.0438
	PhP/Cust/Mo		(24.7884)	24.7884
Industrial				
Distribution	PhP/kWh	0.6008	0.2076	0.3932
	PhP/kWh	23.92	16.50	12.42
Supply	PhP/Cust/Mo	44.61	696.72	(652.11)
Metering	PhP/Meter/Mo	19.89	394.75	(374.86)
Loan Condo	PhP/kWh	0	(0.0225)	0.0225
	PhP/Cust/Mo	0	(46.99)	46.99
Irrigation/Comm. Water System				
Distribution	PhP/kWh	0.6371	0.3113	0.3258
Supply	PhP/Cust/Mo	44.61	88.39	(43.78)
Metering	PhP/Meter/Mo	19.89	285.10	(265.21)
Loan Condo	PhP/kWh	0	(0.0305)	0.0305
	PhP/Cust/Mo	0	(34.7583)	34.7583
Public Buildings				
Distribution	PhP/kWh	1.3567	0.3478	1.0089
Supply	PhP/Cust/Mo	44.61	28.25	16.3626
Metering	PhP/Meter/Mo	19.89	23.28	(3.3923)
	PhP/kWh	0	0.2383	(0.2383)
Loan Condo	PhP/kWh	0	(0.0395)	(0.0395)
	PhP/Cust/Mo	0	(23.17)	23.17
Street Lights				
Distribution	PhP/kWh	1.8840	0.8179	1.0661
Supply	PhP/Cust/Mo	44.61	21.92	22.69
Metering	PhP/Meter/Mo	19.89	19.96	(0.0723)
Loan Condo	PhP/kWh	0	(0.1449)	(0.1449)
	PhP/Cust/Mo	0	(4.7307)	4.7307

Proposed Rates per Customer Class

CAGELCO I proposed the following Distribution, Supply and Metering charges:

		Residential	Commercial	Industrial	Communal H2O System/Irrigation	Public Building	Street Lights
Distribution Charges:							
Demand Charge	PhP/kW			28.92			
System Charge	PhP/kWh	1.7008	0.8030	0.6008	0.6371	1.3567	1.8840
Supply Charges:							
System Charge	PhP/kWh	0.6683					
Customer Charge	PhP/Cust./Mo.		44.61	44.61	44.61	44.61	44.61
Metering Charges:							
Retail Customer Charge	PhP/Meter/Mo.	5.00	19.89	19.89	19.89	19.89	19.89
Metering System Charge	PhP/kWh	0.2230					

Proposed Lifeline Rate Discounts and Subsidy

CAGELCO I proposed a lifeline rate discount for the marginalized end-users based on test year 2005 frequency distribution of residential customers, to wit:

kWh Consumption	Per Approved Unbundled Rates	Proposed in this Rate Application
	Level of Discount	
0 -15 kWh	50%	30%
16 kWh	40%	25%
17 kWh	30%	20%
18 kWh	20%	15%
19 kWh	10%	10%
20 kWh	5%	5%
Subsidy charge to Non-lifeline customers	PhP0.0604/kWh	PhP0.0830/kWh

CAGELCO I proposed a lifeline subsidy charge of PhP0.0830/kWh to non-lifeline customers.

In determining the rate adjustment of CAGELCO I, the Commission took into consideration the following components of the revenue requirement:

- a. Payroll
- b. Operation & Maintenance
- c. Depreciation
- d. Debt Service
- e. Other Revenue Items (ORI)
- f. Reinvestment Fund

Revenue Requirement

The table below shows CAGELCO I's proposed and the Commission's approved revenue requirements:

Account Name	Unbundling (PhP)	Proposed Revenue Requirement using Test Year 2005 (PhP)	Commission's Adjustment (PhP)	Commission's Approved Revenue Requirement (PhP)	Difference from Unbundling (PhP)
4.1.1 Payroll	25,417,179	38,550,490	(2,216,604)	36,333,886	10,916,707
4.1.2 Operation & Maintenance	27,846,448	49,792,180	(14,950,808)	34,841,372	6,994,924
4.1.3 Debt Service plus	10,850,480	24,452,262	(22,466,522)	1,985,740	(8,864,740)
4.1.4 Cash Working Capital	-	7,145,605	(7,145,605)	-	-
4.1.5 Other Revenue Items (ORI)	(4,193,703)	(219,939)	(1,414,667)	(1,934,606)	2,559,097
4.1.6 Reinvestment Fund	18,176,454	86,080,423	(42,908,087)	43,172,336	24,995,882
Total Revenue Requirement	78,096,858	205,801,021	(91,102,293)	114,698,728	36,601,870

Using the Cash Base Methodology under the UFR and 2005 as test year, CAGELCO I proposed a total revenue requirement of **Two Hundred Five Million Eight Hundred One Thousand and Twenty Pesos-One (PhP205,801,021.00)**.

The Commission made a downward adjustment of PhP91,102,293.00, the details of which shall be discussed in seriatim.

OPERATING EXPENSES

Payroll

CAGELCO I proposed a Payroll Expense of PhP38,550,490.00. Based on its "*Summary of Employee Information*", it has Two Hundred Twelve (212) employees in 2005 representing a 4.43% increase in the number of employees from its unbundling of rates level (203).

The adjustment in Payroll from the 2002 level (Unbundling of Rates) was based on its *plantilla* and corresponding budget approved by the National Electrification Administration (NEA). Other adjustments were due to the implementation of the Wage Order approved by the Department of Labor and Employment (DOLE) and overtime pay.

The Commission disallowed the amount of PhP2,216,604.00 pertaining to the overtime pay given over and above the standard calculation. The allowable annual provision for overtime pay is based on average daily basic pay multiplied by the allowable twenty-four (24) days overtime in a year and the total number of employees. ✓

Accordingly, the total Payroll Expense amounted to PhP36,333,886.00


Operation and Maintenance (O & M) Expense

CAGELCO I alleged that the adjustments in its O & M were due to the expansion of the distribution system and the effects of inflation and other governmental requirements which were not provided for in its current unbundled rates.

Generally, the operating expenses allowed are those which are reasonably incurred in connection with business operations to yield revenue or income. It should be necessary in the operation of a distribution utility, recurring and should redound to the service or benefit of end-users.

Distribution Utilities are expected to incur only "prudent and reasonable costs" for inclusion in the determination of retail rates and while they enjoy the benefit of passing their cost of purchased power and other reasonable costs to end-users, they are duty bound as a public utility to ensure that their costs of operations are kept at a minimum.

(This space is left blank intentionally)



The table below shows CAGELCO I's proposed expenses and the Commission's adjustments.

Particulars	CAGELCO I's Proposal (PhP)	Commission's Disallowances (PhP)
Consumer Installation	5,323,366	295,675
Consumer Records & Collection	16,919,628	881,982
Meal Allowances		449,165
Tam Regional Anti-Pilferage Seminar Meals & Allowance		426,606
Franchise Tax withheld by customer		6,211
Office Supplies	4,321,103	2,274,051
Interest on Hold-Out		431,174
NEA -Additional Interest on short-term Loan		24,748
NPC GENCO – Penalty for Late payment of cost of Power purchased		337,925
Payment to SAGIP Loan		1,385,425
Franchise Tax withheld by customer, Cellphone bills of BODs, Dept. Managers & Division Chiefs		30,010 64,769
Miscellaneous General Expenses	2,537,507	630,806
Employees Pension and Benefits	9,169,077	6,989,789
Leave commutation		1,403,051
Bonus		2,784,005
Rice allowance		526,650
Cash Gift		987,083
Medical allowance		243,500
Incentive		945,000
Uniform allowance		100,500
Franchise Requirement	2,597,274	2,597,274
Gasoline & Diesel Adjustment	951,097	951,098
Officers Benefits & Allowances	2,740,426	330,133
13 th month pay		198,800
Cash Gift		58,333
Medical allowance Incentive		13,000
		60,000
Total Commission Disallowances		PhP14,950,808

The downward adjustments were due to the following factors:

a. Consumer Installation and Meal allowances

The grant of meal allowances was considered excessive and, thus, should not be recovered through the rates.

b. Franchise Tax, Interest on Short-term Loans and Penalties

Taxes are recovered through another mechanism. On the other hand, penalties incurred by a distribution utility are not allowed to be passed on to consumers.

c. Miscellaneous and Other Expenses

Said expenses were found excessive and unnecessary in the operation of the business, thus, should be disallowed. Other expenses allegedly incurred were unsubstantiated.

d. Employees Pension and Benefits

Only fifteen (15) days basic salary-equivalent for accrued leave was allowed.

e. Bonus and Other Allowances

Expenses of this nature may be allowed but can not be recovered through the rates. Further, the allowances granted were in excess of the allowable level of benefits.

f. Officers' Benefits and Allowances

Said expenses were found in excess of the allowable level of benefits.

g. Cash Gift, Medical Allowance, Incentive

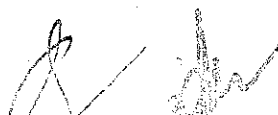
The corresponding deduction was made to account for the discrepancy in the number of Board of Directors (BODs). As declared by CAGELCO I, there were seventeen (17) BODs. However, upon validation, it was found that there were only twelve (12) BODs.

The Commission disallowed a total amount of PhP14,950,808.00 from CAGELCO I's proposed O & M Expense of PhP49,792,180.00.

Debt Service

CAGELCO I proposed the amount of PhP24,452,262.00 for its Debt Service representing the cost of amortizing the new loans acquired after June 26, 2001 as reflected in the NEA Loan Profile and in the ERC approved loan application.

Upon evaluation of the supporting documents submitted, the Commission found that it has already approved three (3) loans pertaining to the 2006 CAPEX projects of CAGELCO I. Said loans were sourced from NEA and from the Rural Electrification Financing Corporation (REFC). It is the Commission's policy to consider all capital expenditure loans in the determination of the ECs' reinvestment funds, said funds having been particularly provided for projects such as CAPEX. Thus, the Commission approved the NEA-Overseas Economic Cooperative Fund (OECF) loan with an outstanding amortization of PhP1,985,740.00 for CAGELCO I's debt service.



Cash Working Capital (CWC)

CAGELCO I alleged that all distribution utilities, whether cooperative or private, need CWC due to abrupt increases in power costs. It further claimed that the present Cash Base Methodology does not have a buffer fund for contingencies. As such, even if the ECs are able to realize savings from fixed cost components of rates due to their enormous load growth, said savings are oftentimes utilized for rehabilitation or expansion of their distribution system.

In its proposed revenue requirement, CAGELCO I intended to recover the amount of PHP7,145,605.00 for its CWC.

CWC is not part of the revenue requirement under the Cash Base Methodology. The present components of the revenue requirement are deemed sufficient to address any possible need for a CWC and any CWC, if required, may be sourced by the ECs from loans, reinvestment fund, and incremental incomes or revenues as a result of increasing kWh consumption.

The CWC is a component of the revenue requirement of the Private Utilities (PUs) under the Return on Rate Base (RCRB) Methodology in the form of return or the cost of money for the two (2) months Net Operating and Maintenance Expense and the resulting purchased power cost due to the lead-lag study on power cost, if any. The rationale being that any working capital needed by the PU is funded by the money invested by the shareholders or investors which requires a corresponding return. In contrast with the PUs, the ECs do not have investors to finance their revenue requirements. ECs are non-profit electric utilities and therefore, are not allowed to any return or profit.

On the basis thereof, the Commission disallowed the proposed CWC of PhP7,145,605.00 as part of CAGELCO I's revenue requirement.

Other Revenue Items (ORI)

In compliance with the directive of the Commission that fifty percent (50%) of the revenue earned for the use of asset-related properties shall be shared with the consumers, CAGELCO I proposed the amount of PhP219,939.00 as ORI to be deducted from its proposed revenue requirement.

In CAGELCO I's unbundled rate, the Commission considered as other revenues those derived from asset-based items or those derived from activities unrelated to its usual business and operation and which are not subject to its regulation. 50% of the income from these asset-based items, however, will still be considered as part of the ORI to be deducted from the total revenue requirement.

In determining the reasonableness of the ORI, the Commission maintained that other revenues earned by the DU using the resources of its regulated business and earned by virtue of its operation as such or those known as regulated items, should be 100% deductible from its revenue requirement.

Regulated items may include revenues derived from the regular functions of the DU and those performed by its own personnel like reconnection, disconnection, relocation and inspection. Since the costs of providing said service, such as salaries, supplies and other miscellaneous expenses, are

already incorporated in the rates, any income derived therefrom should be deducted from the revenue requirement, otherwise, the DU will be doubly compensated for performing the same activities.

Based on the documents submitted, the Commission considered the total amount of PhP1,634,606.00 as other revenues to be deducted from CAGELCO I's revenue requirement. Shown below are the details of ORI considered by the Commission:

OTHER REVENUE ITEMS	Amount (PhP)	Amount Deducted from the Revenue requirement (PhP)
Regulated Items		
Other Electric Revenue	632,600	
Reconnection Fees	138,200	
Calibration Fees	52,080	
Transformer Installation & Dismantling	362,517	
Revenue from Merchandising, Jobbing – Net	180,990	
@ 100%	1,366,387	1,366,387
Asset-based Items		
Pole Rental	536,438	
@ 50%	268,219	268,219
TOTAL ORI		1,634,606

Reinvestment Fund

CAGELCO I proposed a reinvestment fund of PhP86,080,423.00 to recover the costs of capitalized payroll, portion of gasoline, diesel and oil which was also capitalized, average investment for five (5) years which is incorporated in the ERC approved Integrated Computer Planning Model (ICPM) or CAPEX and the refund of the kWh meter deposits per year.

In the unbundling of rates of the ECs, the Commission allowed a Reinvestment Fund equivalent to five percent (5%) of the Gross Revenue. The Reinvestment Fund is being provided as a component of the revenue