

<u>Industry Participants</u>	<u>Comments/Queries</u>	<u>ERC Position</u>
<p>CAGAYAN ELECTRIC POWER & LIGHT COMPANY, INC. (CEPALCO) <i>Comments filed Aug. 20</i></p>	<p><u>GENERAL COMMENTS</u></p> <ol style="list-style-type: none"> 1. The Regulatory year for all Regulatory Period shall coincide with the DUs Fiscal Year for convenience in generating annual financial and operations data. 2. Performance Standards, Measures and Targets should be based on what are prescribed under the PGC and PDC. If the ERC finds additional performance criteria, it should be taken as an amendment to the PGC and PDC instead of prescribing another set of standards as basis for incentive under the DWRG. This is to consolidate and keep the standards setting and measurement consistent. <p><u>SPECIFIC COMMENTS</u></p> <ol style="list-style-type: none"> 1. <i>Calculation of the Base Rate (Initial Maximum Average Price, MAP₂₀₀₅) Used in Setting the First MAP (MAP₂₀₀₆)</i> <p>MAP₂₀₀₅ that serves as the base rate in setting the MAP for 2006 is suggested to be set based on the DUs Revenue Requirement for Year 2005 operations instead of setting it based on actual revenue for 2005 which was derived using the DUs unbundled rates. The Revenue Requirement shall be the normalized revenue requirement for 2005 based on the revenue requirement and RORB methodologies adopted by the ERC in its approval of each DUs unbundled rates</p>	<p>Timing set to stagger price change effects from TRANSCO and DU annual tariff verification and adjustment process and to spread work load for ERC. How many private DUs have a calendar fiscal year? What other fiscal years are used?</p> <p>The ERC is working on guidelines to set the performance standards and measures with are in line with the PDC. The intention with DWRG is to link its standards and measure to PDC. These are likely to be in place before the start of the 2nd Regulatory Period, so the two documents / processes should be in line with each other.</p> <p>The ERC understands the issue, but what alternative is being suggested? One alternative might be for ERC to enter a regulatory reset under Article IV, including revaluation of assets. As the rest is scheduled to take approximately 18 months, the prices for this additional period will still be on previous cost base. The options appear to be either:</p> <ol style="list-style-type: none"> 1) move straight to a reset under DWRG; 2) apply approved unbundled rates to 2004 billed

	<ul style="list-style-type: none"> • If $RBR_{2006} > RBR_{2005}$, then RBR_{2006} should only be the <u>excess</u> amount from that of RBR_{2005} • If $RBR_{2006} < RBR_{2005}$, then: RBR_{2006} should be the difference between RBR_{2006} and RBR_{2005} <p><u>Annex A</u> shows a sample computation.</p> <p>3. <i>Possible over/(under)-recovery due to changes in the AWAT not caused by price but due to changes in actual kWh sales mix over the base sales mix used in setting the MAP</i></p> <p>The level of the actual weighted average tariff, or AWAT, changes when there are substantial changes in the customers' sales mix during a regulatory year. As an example, when a high voltage customer of a Regulated Entity cease to operate during the Regulatory Year, AWAT for that year becomes higher as compared to the year when such customer is still operating. This is because high voltage customers have normally lower rate than the low voltage customers. Such that when a high voltage customer with a lower rate cease to operate, bulk of the sales goes to higher rate customers, thereby increasing the weighted average price. When this is compared to the MAP of previous year, which has a</p>	<p>CEPALCO suggest the is based on “net revenue” and hence query whether or not there is a ‘double count’ in the RBR, and in particular with respect to the issue of ‘cumulative additions’. The ERC seeks further feedback.</p> <p>The CEPALCO example is symmetrical, but the words suggest non-symmetrical. Please explain.</p> <p>Discussion confirmed that DWRG and its adjustment was only controlling wheeling rates and was not controlling the retail rates of supply. The ERC queries whether or not the CEPALCO comments are still relevant given this understanding. Further feedback is sought.</p>
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	<p>different sales mix as the AWAT, over/(under) recovery will ensue.</p> <p>We propose that in the computation of the AWAT, normalization shall be done to consider the base sales mix as used in the determination of the MAP.</p> <p><u>Annex B</u> shows a sample computation.</p> <p><i>4. Adjustment to account for over/under recovery and the surcharge imposed for over recoveries beyond 5% in Regulatory Year 2007</i></p> <p>(1) What is the rationale for imposing 4% surcharge on over recovery beyond 5% applied starting in Regulatory Year 2007?</p> <p>(2) For Regulatory Year 2008, DU should be allowed to fully recover in 2008 its under recoveries in 2007. The formula limits recovery up to 5% of the total under recovery if under recovery is more than 5%.</p>	<p>What sales mix (kWh) is CEPALCO proposing to use as the “base” case? Is it ---</p> <ul style="list-style-type: none"> - forecast at beginning of year under Article VI? - the previous year’s actual sales mix? <p>Discussion suggested others could be:</p> <ul style="list-style-type: none"> - the sales mix at the reset on the base year prior to the 1st regulatory period, ie: 2005 - then forecast on weighted average sales mix. <p>CEPALCO suggest that the principle is to use what is the driver of the MAP.</p> <p>CEPALCO to please explain Annex B.</p> <p>The ERC would prefer the private DUs to not excessively recover their price cap. The penalty is set to encourage recovery but not over-recovery.</p> <p>This is to ensure DUs seek to recover their costs in a smooth manner without rate shock. Experience in other jurisdictions suggests the under-recovery mechanism can be used as a “bank” to generate extra returns through “I” which customers need to repay in future periods. As such</p>
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	<p><i>5. Effect on revenue from monthly fixed charges per customer and minimum bills for customers consuming less than guaranteed kWh to the AWAT</i></p> <p>One possibility that would result to AWAT higher or lower than MAP or the price cap is the change in revenue from fixed monthly charges component of the DUs' Total Revenue that forms part in arriving at the MAP and the AWAT. An example of these fixed monthly charges is Customer Charge, which is driven by the number of customers and the Minimum Bills imposed on customer that fails to consume the minimum billing quantity. These charges are necessary for the DU to be compensated with the unavoidable expenses regardless of customers' kWh consumption i.e. metering, billing and collection costs.</p> <p>Hence, it is suggested that the AWAT shall be adjusted so that the proportion of the revenue from the Fixed Charges in the AWAT shall conform to the ratio in peso per kWh that forms a component of the MAP.</p>	<p>under-recovery can lead to price shocks at a later date, the ERC would prefer no long-term recovery to apply.</p> <p>The ERC is seeking to stop excessive price shock. Also the ERC suggests it needs further feedback on the +/- 5% band to see if this range is workable or too restricted.</p> <p>The ERC assumes CEPALCO is proposing to do this adjustment on each customer segment proposed. Is this correct?</p> <p>The discussion suggested there were three options:</p> <ol style="list-style-type: none"> 1) normalization; 2) averaged overall; 3) adjust AWAT to reduce price shock.
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	<p><u>Annex C</u> illustrates the proposed adjustment factor.</p> <p>6. <i>Adjustment in MAP for 1st Regulatory Period due to Major Unforecasted Asset Acquisition or Adjustment in the efficiency factor, X, which is zero during the First Regulatory Period (FRP).</i></p> <p>(1) There is <u>no provision</u> in the First Regulatory Period on how the efficiency factor, X shall be recalculated. If the provision in the Second Regulatory Period (SRP) is instead applied to recalculate the X factor then X can be calculated, although the original intention of this section is for revenue smoothing to reduce likelihood of price shock, see Section 4.13. <i>If this is done, it will appear that the SRP shall have started earlier than 2008.</i></p> <p>(2) There should be a negative value for X during the First Regulatory Period to account for the expected capital expenditures to be incurred by the DU as contained in the Compliance Plan submitted to the ERC as required under the PDC & PGC.</p>	<p>The ERC seeks further feedback on this issue.</p> <p>CEPALCO to please explain Annex C.</p> <p>The X factor adjustment is designed to capture the purchase of sub-transmission assets. The mechanism to adjust the X factor in 1st regulatory period is undefined. However, the process in Sections 12.3.2 to 12.3.5 allows for submissions from the regulated entity before ERC determines a new X factor. One mechanism would be an analysis of the agreed/approved revenue potential of the assets smoothed on an NPV basis over the remaining regulatory years in that regulatory period. What mechanism would CEPALCO suggest? Should this be included in the DWRG?</p> <p>What % of annual revenue has this expenditure been? Is it material on asset base value or revenue terms?</p> <p>CEPALCO suggests that PDC compliance has raised its costs which is not in the current rate base and hence not in the current rates. The ERC should consider a negative X Factor should be put into s.3.5 of the draft DWRG. ERC understands that each project undertaken by a DU may have a corresponding revenue cap impact, so this</p>
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	<p><i>7. Sanction for DU's non-payment to ERC of Experts' Fee, i.e. automatic increase in the recalculated X factor by 0.02.</i></p> <p>(1) What is the rationale for increasing the value of X by 0.02 when X is recalculated for Deferred Capital Expenditures on significant Projects for Second Regulatory Period (Section 12.2.3 page 118); Major Unforecasted Acquisitions for the Second Regulatory Period (Section 12.4.7 page 122)?</p> <p>(2) What is the rationale for taking the penalty for DU's failure to pay on time for the Expert Fees as a reduction in the price cap or MAP?</p> <p>(3) The penalty in terms of interest from the time the fee falls due until full payment should be enough surcharge as imposed under Section 14.4.3, page 129.</p>	<p>information should be made available to the ERC.</p> <p>This provides a revenue penalty if DUs do not meet their regulatory obligations to spend CAPEX that is approved and included in rates within a reasonable time frame. It is set at a level in excess of the cost of the project deferred. What level does CEPALCO propose for a penalty? The ERC notes the last sentence relating to s.12.4.7 is not a new penalty, but a clause to allow the previously discussed penalty to apply in the situation described in s.12.4.7. Any penalty X factor applied under Section 12.2.3 should also reflect any X factor changes due to new acquisitions from Section 12.4.4.</p> <p>Main issue is to provide an incentive for DU to meet its regulatory obligations. What penalty for late payment is suggested? CEPALCO suggest general practice in contract should be sufficient.</p> <p>Agreed.</p>
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<p>DAGUPAN ELECTRIC CORPORATION (DECORP) <i>Comments filed Aug. 23</i></p>	<p><i>Customer.</i> In our case, the franchise for the municipality of Laoac, which we previously served, had been awarded to PANELCO III. However, the distribution system in Laoac acquired by PANELCO III is still being served by DECORP at the Medium Voltage level. Moreover, if a DU would acquire solely TRANSCO's sub-transmission lines serve multiple DUs, effectively the non-acquiring DUs become customers of the acquiring DU.</p> <p><i>Force Majeure Event.</i> Labor unrest and/or strikes pose an impact to the operation of our customers, thus reducing their energy consumption, which would lead to overall reduction in our energy sales. Effectively, such will increase the weighted average cost of energy. We recommend to include labor unrest and/or strike in (b).</p>	<p>This is a matter to be considered separately to the draft DWRG. It is a sub-transmission transfer issue. ERC queries whether the transfer described is possible under the EPIRA. Seems to hinge on the definition of "customer" where one or more DU's waive their rights to be involved in an acquisition. ERC seeks further feedback on this issue.</p> <p>Any comments from interested parties?</p> <p>The ERC believes this is more appropriately a DU responsibility (refer pg 105 Article X and definition on page 6), as it is normally a controllable event by management intervention. This could include an appropriately worded contract between large supplier and the DU. It is a stretch to call labor unrest a 'force majeure'.</p>
<p>ILIGAN LIGHT & POWER, INC. (ILPI) <i>Comments filed Aug. 25</i></p>	<p><i>Over/Under Recovery Formula (Sec. 3.4).</i> Does the amount to be inputted for the computation of the Actual Weighted Average Tariff are those only derived from the Distribution Wheeling?</p> <p><i>Revaluation of Assets (Sec. 4.6.6).</i> Optimization principle revaluation of the assets employs that: Assets that are assessed to have over-capacity or excess redundancy (over-designed or excessive installed capacity) will have their value split between the value of that capacity or redundancy necessary to meet customer requirements and the value of capacity or redundancy in excess of the requirement.</p>	<p>No, it is all revenues associated with Regulated Distribution Services under Section 1.3, page 8.</p> <p>This is correct.</p>

	<p>In effect, exclude the value of excess capacity or redundancy in the revaluation of assets? How does excluding excess capacity from regulatory asset base reconcile with the need to ensure service reliability? If intent is to safeguard against over-building of installed capacity, we expect application to be prospective; this principle may eventually be applied on the planned acquisition of some redundant NPC sub-transmission assets by distribution utilities.</p> <p><i>Performance Incentive Scheme (Sec. 8.2).</i> What would be the basis that the ERC will follow in the determination of the Performance Incentive Scheme applicable to the DU considering that there are two schemes presented under Section 8.2.2 within which has a corresponding level of reward and penalty set as stated in Section 8.2.3c?</p>	<p>The calculation of excess capacity must exclude capacity necessary for load/energy growth over the planning horizon [suggested at 5 years in Section 4.6.6(b)], good engineering practice regarding network redundancy rules, and the service performance targets under the PBR (Section 8.1.3).</p> <p>Treatment of acquired sub-transmission assets are guided by both the Sub-Trans Guidelines, and the applications under Section 12.3 and Section 12.4 by the Regulated Entity.</p> <p>The total of all schemes should be less than the caps provided in Section 8.2.3 (c). What caps does Iligan Light propose?</p> <p>The ERC is open to options recognizing the PDC already mandates a form of rebates for poor customer service under clause 3.5.1.2. What does Iligan Light propose in addition?</p>
<p>MANILA ELECTRIC COMPANY (MERALCO)</p>	<p><u>GENERAL COMMENTS</u></p> <ol style="list-style-type: none"> 1. The very limited time accorded to the utilities on the DWRG was not sufficient to allow for detailed and comprehensive comments on the guidelines. 2. The annual adjustment in tariffs due to movements in the CPI and the foreign exchange rate and the facility to pass on the impact of force majeure events and changes in taxation are definitely welcome. 	<p>Understood. There is a second public consultation phase on October 19, 2004.</p> <p>No comment.</p>

	<p>3. Setting the proper level of MAP for 2005 is critical in this proposed framework.</p> <p>4. The MAP for 2005 should be at a level that allows for the recovery of just and reasonable costs and provides the distribution utility a reasonable return on its investments.</p> <p>5. Through the years, the power industry in the Philippines has already developed a “power industry language” that is clearly understood by industry participants. Any effort to simplify the terms for private distribution utilities should help facilitate understanding of the draft DWRG Manual. A lot of the terms, many of which are not familiar, have to be understood first before one can comment effectively on the DWRG.</p> <p><u>SPECIFIC COMMENTS</u></p> <p>1. <i>Section 1.3, Regulated Distribution Services, f.</i> There should be a proper definition of “inset networks” in Article 1.3 (“Definitions”) as the term was just given a passing definition by way of an example on page 10. More elaboration of such a system is needed for a better appreciation of the situation being referred to.</p> <p>2. <i>Section 2.2, 2.3, 2.4.</i> What is the rationale behind the use of regulatory period starting and ending on a mid-year? Distribution utilities practices and systems have already been set up to a year-end reckoning and departing from such practice appears to be unnecessary. It also makes monitoring difficult and the identification of the relevant quarters confusing.</p>	<p>Agreed.</p> <p>No comment.</p> <p>The ERC agrees simplification would assist, but recognizes that as a legal document guiding the DUs, the ERC and independent experts, the definitions need to be unambiguous. ERC will attempt to do this, but industry participants must recognize that all definitions need to be legally binding.</p> <p>Agreed. Is there an existing definition in law that ERC should consider?</p> <p>This is to even out the ERC workload during major rests and the Article VI processes. What date is MERALCO suggesting as the start date?</p>
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	<p>3. <i>Section 3.2.1, 3.4.1b.</i> There is a need to establish the relationship between the “Maximum Annual Price” cap and the “maximum average price” as the same acronym is used for these two terms. On pages 22, 30, 16, 117, 118, 119, 121, the acronym MAP is made to refer to “Maximum Annual Price”. However, on pages 27, 28, 29, 32, 33, 34, 67, 68 etc., the same acronym is made to refer to “maximum average price”.</p> <p>4. <i>Section 3.3.1.</i> What is the rationale behind the using a 60-40% sharing among movements in FOREX and CPI? It may be more appropriate not to fix the percentage sharing but to let the magnitude of the changes between FOREX and CPI as it impacts the Utility’s cost structure naturally determine which will affect the CWI formula more.</p> <p>An explanation is also sought on how come the formula becomes a full CPI index if the Forex difference does not reach a certain threshold.</p> <p>5. <i>Section 3.3.2.</i> Why are there overlapping quarters in the periods covered by the numerator and denominator of the formula for calculating DeltaCPI? (That is, there is a quarter in the numerator [Q4, t-2] which lies inside the period covered by the numerator.) What is the reason for this complicated time segmentation? Can we not adopt a much simpler formula for DeltaCPI, by having four consecutive quarters in the numerator and the immediately preceding four consecutive quarters in</p>	<p>MAP is a defined term, Maximum Annual Price, which is the price cap the DUs need to meet. Generally, “maximum average price” is the term for the measure of the actual outcomes.</p> <p>Ratios based on recent or forecast capex cost structure (ie: either local in peso or overseas converted to US\$) What approach to setting W1 and W2 does MERALCO propose?</p> <p>Generally, the adjustment is only for CPI. If changes to USER are above 8% or below -8% for two successive quarters, the adjustment is a combined CPI and FOREX adjustment. (See Section 12.5.2.) Other re-opening triggers apply.</p> <p>ERC’s primary concern is to “actual” data from an independent source. Thus lagged data is required. Time segmentation provides some response to quarterly spikes but does same smoothing compared to “point-to-point” measures. Could MERALCO provide an example of its proposal?</p>
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	<p>the denominator?</p> <p>Can we not use the same subscripts for the same quarters in the same way that the calendar quarters are subscripted? That is, January 1 to March 31 be designated as Q1 instead of Q3, April 1 to June 30 be labeled as Q2 instead of Q4, July 1 to September 30 be assigned as Q3 instead of Q1, and October 1 to December 31 be tabled Q4 instead of Q2? This would avoid a lot of confusion. If this convention is adopted, the subscripts in the affected formulas (e.g., for DeltaCPIt) be easily changed without any effect at all.</p> <p>6. <i>Section 4.1.2</i> should clearly indicate that there will be an annual determination, not a monthly determination, of whether the maximum average price that a utility charges its customers does not exceed the Maximum Annual Price Cap. Average price is affected by the sales mix. Considering that the distribution charges of the utility vary per customer segment or class, increasing sales for higher-rate customers (typically during summer) means average price for certain months will be higher than the annual average, and vice-versa. Using annual averages will remove the monthly distortions caused by changes in sales mix. An annual reckoning also considers that impact of load factor changes on the average rate of customers billed on the basis of demand charges. On months wherein load factor is low for these users, the average rate may be higher than the annual average. A monthly determination may result in the utility being penalized during months when the utility exceeds the cap although on an annual basis, the annual average</p>	<p>ERC will review this when looking at the start date. Complexity in interpretation acknowledged.</p> <p>No monthly calculation is stated or inferred. Where 12 month averages or caps are used seasonality should not be an issue.</p> <p>MERALCO to elaborate its concerns.</p>
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	<p>price cap is not exceeded.</p> <p>7. <i>Section 4.6.5.</i> ERC issued Order dated October 30, 2001 (ERC Case No. 2001-873), prescribing uniform filing requirements (UFR) for the rate unbundling including a UFR worksheet. General instructions in the UFR on Financial Accounts stated that “the utility shall match the accounts referenced herein using the descriptions provided in the Rural Electric Cooperatives Manual, issued June 1992 by the National Electrification Administration.” This Manual contains the uniform system of accounts being followed by cooperatives. The DWRG is now prescribing asset categories that do not exactly follow that prescribed in the unbundling. Some of these are as follows:</p> <ul style="list-style-type: none"> a. As in the case of towers and poles, the associated lines are classified under overhead conductors under the Cooperatives Manual as shown in the UFR worksheet. b. The substation account (station equipment) is not broken down into details as in the DWRG, in the UFR worksheet. c. Likewise, the communications plant (communication equipment) is not detailed in the UFR. d. Groupings of the non-network assets is not the same in the UFR. <p>8. <i>Section 4.6.9.</i> “Spend profile” mentioned on page 46</p>	<p>The ERC is open to suggestions for change to the asset category list in Section 4.6.5. What does MERALCO propose? Note that ERC prefers more detail on asset categories than less so that the regulatory life and weighted average age can be applied on a more realistic and less aggregated basis?</p> <p>Subject to ERC’s preference above this change may be possible.</p> <p>Will probably not meet the ERC’s objectives, as asset lives are unlikely to be the same as poles, towers or wires.</p> <p>Will probably not meet the ERC’s objectives, as asset lives are unlikely to be the same as poles, towers or wires.</p> <p>What does MERALCO propose?</p> <p>ERC notes comment.</p>
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	<p>should also have an entry in the Definition of Terms.</p> <p>9. <i>Section 4.7.2.</i> “Asset Category” should also be included in Article 1.3.</p> <p>10. <i>Section 4.10.5.b.</i> What is a “reasonable” forecast for the PhP/US\$ exchange rate and CPI? There should be clear parameters for assessing the reasonability of these forecasts. Since the distribution utilities operate within the same macroeconomic environment, will the projections for these economic variables be applied across all distribution utilities?</p> <p>11. <i>Section 5.11.2.</i> Clarification is sought on the big question mark shown in the formula for ITAt. Is this a typographical error or is this a pending issue for ERC resolution?</p> <p>12. <i>Section 8.2.</i> There is a need to establish a clear link between the performance incentives and the annual revenue requirement formulas.</p> <p>13. <i>Various Sections.</i> For clarity, there is a need to indicate the dimensions or units in the terms that are used in the computation.</p>	<p>ERC notes comment.</p> <p>The suggestion that a “uniform forecast” for CPI should be used is a valid proposal. What source is MERALCO proposing? Industry consensus? Independent government agency? Other? Does MERALCO propose a national CPI, regional CPI or an overseas CPI (eg: USA), and what is the data source proposed?</p> <p>This is a software incompatibility during printing of the draft DWRG. It should be read as a summation sign.</p> <p>ERC is open to suggestions on how to set the limits provided in Section 8.2.3 and potential additions to Section 8.2.3. ERC prefers to set the specific PBR mechanisms during the detailed regulatory reset process. Any suggestions to edit Section 8.2.2 and Section 8.2.3 would be appreciated.</p> <p>Comment noted.</p>
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