

**ERC Case No. 2005-041RC**

**In the Matter of Undertaking a Revenue Reset for the National Transmission Corporation (TRANSCO) and Any Future Concessionaire Thereof for the Period 2006 to 2010 in Accordance with the Alternative Form of Rate Setting Methodology under the Transmission Wheeling Rate Guidelines (TWRG) – Draft Determination**

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Chapter 1				
1.3.1, (p 2)	The Purpose of the Draft Determination	TRANSCO	<p>The Commission states that the Draft Determination “describes the ERC’s initial evaluation of TransCo/PSALM’s application for its revenue reset” and “is designed to afford other stakeholders an opportunity to comment on the ERC’s views”. However, the Draft Determination does not set out the basis and rationale for all of the proposed decisions, nor has the Commission released a copy of its model (and hence its detailed interpretation of the TWRG, its calculations and assumptions).</p> <p>TransCo/PSALM and other stakeholders have therefore not had an opportunity to comment on all aspects of the Draft Determination in an informed manner. TransCo refers the Commission to the principles for consultation on Draft Determinations established by the Australian Energy Regulator in its Compendium of Electricity Transmission Regulatory Guidelines, August 2005. These principles commit the AER to “publish full and reasonable details of the basis and rationale for the proposed decision, including but not limited to: Reasonable details of qualitative and quantitative methodologies applied including any calculations and formulae</p> <p>The values adopted for each of the input variables in any calculations and formulae, including a full description of the rationale for adoption of those values.</p> <ul style="list-style-type: none"> <li>• Reasonable details of other assumptions made in conduct of all material qualitative and quantitative analyses undertaken in relation to the setting of a revenue cap or related matter</li> <li>• Full reasons for all material judgments and qualitative decisions made and options considered, and all discretions exercised which have a material bearing on the outcome of the AER’s overall decision.” (AER, Compendium, pg 20)</li> </ul> <p>Applicants submits that these are reasonable principles for ensuring that all stakeholders are sufficiently informed so that consultation is meaningful. The draft determination falls short of meeting these principles in a number of aspects, as detailed in the comments below. To remedy this situation, the Applicants propose the following courses of actions:</p> <ol style="list-style-type: none"> <li>a. The ERC to provide the basis and rationale for all its proposed decisions prior to the start of the hearings/ public consultations in relation to the Draft Determination so that all stakeholders have an opportunity to comment during the hearings; or</li> <li>b. The ERC releases a complete Draft Determination with full and reasonable details of the basis and rationale for the proposed decision by 15 February 2006, with comments due 31 March 2006. The ERC would consider these comments prior to publishing its final decision by April 30, 2006 as currently scheduled.</li> </ol>	<p>The ERC provide TransCo and other stakeholders with a further opportunity to comment on the ERC’s proposed decisions before it makes its final determination.</p> <p>TransCo proposes that the ERC release a complete Draft Determination with full and reasonable details of the basis and rationale for the proposed decision by 31 March 2006, with comments due April 15. The ERC would consider these comments prior to publishing its final decision by April 30, 2006 as currently scheduled.</p>

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<b>Chapter 2</b>				
Chapter 2 (Page 4)	Forecast of CPI, FOREX and Demand	MERALCO	ERC is correct in choosing the lowest possible values of CPI and forex. Transco's use of the highest CPI forecasts from EIU for both Philippine Peso (higher than NEDA's high scenario) and the highest US dollar to peso exchange rate forecast from PPP is inflationary and will bloat their revenue requirement and subsequently the expected wheeling rates to distribution utilities like Meralco which are passed on to the latter's customers.	
2.2.3 (p 5)	GDP forecasts	TRANSCO	In the second sentence of this subsection, the Draft Determination states "... where all the forecasters use an "actual" GDP number for 2006, except NEDA,...". The reference to the year 2006 appears to be a typo and should be a reference to the year 2004. (see figure 2.2, page 5)	Please note that there is a typo in the sentence quoted from the Draft Determination. The reference should be to year 2004 not year 2006.
Chapter 2.2.3 (Page 5)	GDP Forecasts- Philippines	MERALCO	Typographical errors (in bold face): "The forecasts are provided in Figure <b>2.2</b> below, where all the forecasters use an 'actual' GDP number for <b>2006</b> , except NEDA..."	Change the referred year which is 2006 to 2004, as indicated in Figure 2.2.  Thus, it should read: "The forecasts are provided in Figure <b>2.2</b> below, where all the forecasters use an "actual" GDP number for <b>2004</b> , except NEDA..."
Chap. 2, Sec. 2.5.11, page 9	ForEX Forecasts – Peso / USD	FDC - Cebu	a more precise estimation of the applicable CPI could be arrived at by adjusting forecast displays, by available data provider, for any systematic forecasting error as against the actual reported figure over time (same discussion as to Peso / USD exchange rate)	a mathematical regression analysis may be conducted on the data supplied by various forecasters (as used in the presentation) and extrapolating therefrom the most feasible figures with the least possible margin of error, basis: corrected 2001 – 2004 data (if possible 2005 when already available before cut-off date for preparation of final determination
2.5.2 (p.8)	Foreign exchange forecasts – Peso/US\$	TRANSCO	The EIU forecasts have shown an appreciation in Peso and the Draft Determination states that "there is some recent evidence from the market data to suggest this outcome might be unfolding".  The Applicants believe that the recent Peso rallies against USD have already reflected the positive factors (e.g. reduced budget deficit, strong current account surplus, recovery of both foreign direct investment and portfolio equity investment, etc.) and there seems slim chance that the recent short-term Peso appreciation will be unfolding in the future.	EIU forecasts of an appreciation in Peso are unrealistically optimistic and contradict with historical Peso depreciation trend, and therefore should not be adopted by the ERC.

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2.5.3 (p.8)	Foreign exchange forecasts – Peso/US\$	TRANSCO	The Draft Determination states that “the ERC has confirmed that the Transco/PSALM figures effectively use this method [PPP] based on a 2005 reference exchange rate outcome of 65.0 Peso/US\$.” The Applicants in fact used a reference exchange rate outcome of 56.0 Peso/US\$.	Please note that there is a typo in the sentence quoted from the Draft Determination. Transco/PSALM have used the purchasing power parity method (PPP) on a 2005 reference exchange rate outcome of <b>56.0</b> Peso/US\$
2.5.9 (p.9)	Foreign exchange forecasts – Peso/US\$	TRANSCO	<p>The Draft Determination states that “the ERC would prefer not to choose forecasts which may have a greater probability of having the trigger points activated.”</p> <p>By deliberately choosing the lowest forecast for each of the CPI and Foreign Exchange series, the ERC is increasing the probability that the triggers will be activated.</p> <p>The ERC assume that the Peso will appreciate against the US\$. This assumption conflicts with accepted economic theory (the higher CPI increases expected in the Philippines relative to the US mean that the Peso should devalue against the US\$). The ERC assumption of an appreciation in the Peso also conflicts with historical experience – see Attachment 1 and comments further below.</p>	The ERC should adopt unbiased estimates of CPI and foreign exchange forecasts to minimize the probability of trigger points being activated.
2.5.10 (p.9)	Foreign exchange forecasts – Peso/US\$	TRANSCO	<p>The ERC stated that there are a number of safeguards for both Transco/PSALM and for the ERC embedded within the TWRG, so where divergence between the forecasts and the actual outcomes occurs, the TWRG should reasonably accommodate such changes in economy wide performance.</p> <p>The mechanisms adopted in the TWRG for exchange rate adjustments only kicks in when the exchange rate diverges by +/- 10% from the approved forecast exchange rate. These mechanisms are therefore not tight enough to protect against quite adverse potential outcomes.</p>	The ERC should adopt unbiased estimates of CPI and foreign exchange forecasts to minimize the probability of trigger points being activated.
2.6	Demand Forecasts (General Comments)	TRANSCO	<p>The Demand Forecasts adopted by the ERC for the Draft Determination differ only slightly from the levels of the Applicant’s submission. Nevertheless, we observe the following inconsistencies in the tables and data cited in the Draft Determination.</p> <p>For clarification, there is a basic difference between the past sets of forecast and the present TransCo Regulatory Reset filing as far as the Luzon grid is concerned. The demand projections for Luzon under the Power Development Plans (PDPs) cover all known users of electricity; i.e. including some users/generators not connected to the grid. The demand projections for the PDP are prepared in this way because the PDP covers all users of electricity, regardless of where these are connected.</p> <p>However, the TransCo measured system peak demand data refers only to those users of electricity served by non-embedded generation. As far as we are aware, the DOE add demand being supplied by embedded generation to the system peak demand data measured by TransCo. Hence care is needed in the treatment of data from TransCo and from DOE.</p>	Note DOE demand forecasts cover all demand, whether served via the transmission network or from embedded generation. TransCo forecasts cover only demand served via the transmission network.

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2.6.3, Table 2.1 2.6.4, Table 2.2	Demand Forecasts	TRANSCO	<p>The Applicants note the following inconsistencies in Table 2.1 and Table 2.2 on page 11 of the Draft Determination:</p> <p>The footnotes to Table 2.1 claim that the data are sourced from PDP 2003 and PDP 2004. However, a review of documents showed that forecast system peak demand labeled as (3) in the table is, in fact, based on PDP 2002 and not on PDP 2003.</p> <p>The forecast system peak demand levels, labeled as (4), for Mindanao seem to come from a different PDP version as those for Luzon and Visayas.</p> <p>Please note that the labeling of the Transmission Development Plan(s) (TDPs) and the PDPs is not the same, i.e., TDP 2002 is consistent with PDP 2001, TDP 2003 is consistent with PDP 2002, TDP 2004 is consistent with PDP 2003, and so on.</p> <p>As noted in our general comments for 2.6 above, the system peak demand forecast under the PDP measures all demand, whether or not supplied via the transmission grid, where the TDP forecasts peak demand over the transmission grid. Hence system peak demand, labeled as (5) in table 2.1, should not be compared with the projections under (3) and (4) on the same table since these refer to different measurements.</p> <p>Also, note that 2004 recorded actual system peak demand for Visayas should be 963 MW as provided in Table 2.3 instead of the 955 MW found in Table 2.1.</p>	<p>Correct the forecast demand data contained in Tables 2.1 and Table 2.2.</p> <p>Take care to ensure comparisons are between consistent data series.</p>
2.6.5 Table 2.3	Historical System Peak Demand	TRANSCO	<p>The figures contained in Table 2.3 refer in most cases to TransCo's historical SPD (excluding demand met by embedded generation), but in some cases refer to DOE's total system data (inclusive of demand met by embedded generation) – see comment on the difference between these measurements as discussed in 2.6 above Attachment 2 to these comments contains a table comparing the data in Table 2.3 with the recorded measurements of TransCo. This table also shows our computation of the average compounded growth rates.</p>	<p>Correct data in Table 2.3 to ensure comparisons use consistent measurements.</p>
Chapter 2.6.5 (Page 12)	Demand Forecasts "Source: DOE Draft TDP for 2005"	MERALCO	<p>Where did the historical demand in Table 2.3 come from? The TDP is supposed to be made by Transco, not DOE, so why does Table 2.3 have the label "Source: DOE Draft TDP ..."? Or does it simply mean that the Draft TDP was obtained not directly from Transco but indirectly from the DOE?</p>	<p>For clarification</p>
2.6.6 Table 2.4		TRANSCO	<p>Table 2.4 is labeled as Historical Average Compound Growth Rate for SPD%. This label is not correct as Table 2.4 contains only simple averages and not average annual compounded growth rates.</p>	<p>Correct data in Table 2.4 to ensure comparisons use consistent measurements and to show compound not simple averages.</p>

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Chapter 2.6.9 and 2.6.10 (Page 14)	Demand Forecasts	MERALCO	Transco's average forecasted load growth of 3.62% for the period 2005-2014 and ERC's recommended 4.1% annual growth for 2005-2010 for the Luzon grid, appear to be optimistic.	ERC should lower the forecasted load growth rate for the Luzon grid from 4.1% to a level close or lower than Transco's 3.62%. An unrealistically high forecasted load growth rate for Luzon will translate to higher revenue requirements and consequently, higher transmission wheeling rates.
2.6.8 Table 2.5	TDP 2005	TRANSCO	There is a typographical error in the Table 2.5 (TDP document). Please note that the projected system peak demand for Luzon in year 2012 should be 12,871 MW and not 12,817 MW.	Please correct typographical error – projected peak demand for Luzon in year 2012 should be 12,871 MW, not 12,817 MW.
2.6.13 Figure 2.8 2.6.14 Figure 2.9	Visayas Forecast SPD Mindanao Forecast SPD	TRANSCO	The entries for TransCo in Figure 2.8 for the years 2011 to 2014 for Visayas and Mindanao are not consistent with our data submission. For Mindanao, the levels in the table seemed to have mixed two sets of forecasts we provided DOE.	Correct entries for TransCo in Figure 2.8 to reflect Applicants data submission.

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2.8.4 (p 19)	CPI and Foreign Exchange forecasts	TRANSCO	<p>The Commission identifies two sets of internally consistent forecast series. These are the EIU forecasts set out in table 2.13, and the Applicants forecast data set shown in table 2.11. The Applicants forecast series is internally consistent because it uses the accepted economic theory of purchasing power parity (PPP) to derive an exchange rate forecast from two consistent CPI series. The forecasts data set contained in Table 2.12 (the lowest forecasts data set) is not internally consistent and should be rejected by the Commission under its own evaluation criteria as stated in section 2.5.5.</p> <p>The difference between these two, internally consistent, forecast data sets concerns the exchange rate forecasts - the minor differences in the CPI forecasts are accounted for by the timing differences between when the Applicants and the ERC sourced data from the Economist Intelligence Unit (EIU).</p> <p>The relevant consideration in deciding between the two forecast series for foreign exchange is which series is more likely to predict future exchange rate movements. In this regard, historical success in predicting exchange changes is relevant. Attachment 1 shows that an analysis of historical data from 1970 reveals that PPP has correctly predicted the trend in exchange rate changes, but under-estimated the true extent of Peso depreciation. The Applicants were not able to obtain historical comparisons of EIU exchange rate forecasts, and notes that the ERC was similarly uninformed on the accuracy of the EIU forecasts. On current information, the Commission faces a choice between a set of exchange rate forecasts of unknown accuracy, and an exchange rate series estimated using the accepted economic theory of PPP (which has proven to accurately predict the trend in Peso/US\$ exchange rate since 1970).</p>	<p>Forecasts contained in Table 2.12 (lowest forecast data set) are not internally consistent and should be rejected by the ERC under its own evaluation criteria.</p> <p>The PPP theory has correctly predicted the trend in Peso/US\$ exchange rates since 1970. In the absence of historical information on the accuracy of the EIU exchange rate forecasts, the Commission should adopt the accepted theory of PPP for estimating exchange rate changes. Please see comments on section 2.10.1 below for further justification for using PPP.</p>
Section 2.9.1 and 2.9.2	Demand Forecasts	LAPOCOF	<p>We fully agree that the transmission network design be analyzed on the basis of the load (MW) in various points in the network and in comparison with installed capacities (MW). This is the most reasonable approach. The transmission network therefore shall be improved and expanded on the basis of the installed capacities – not just on the projected demands. As stated in 2.6.1, “ Forecasts for the Systems Peak Demand (SPD) are developed by DOE, NPC and TRANSCO, each having a different approach”. Everyone then can make demand forecast – to suit their individual objectives. The realities however is that forecasts are just that, plain forecast.</p> <p>In the case of Transmission infrastructures however, no amount of demand forecast will suffice unless the generation of power is “harmonized” with it. And in power generation, to us the more important driver is not only the demand forecast but the commitment to install the generating facilities allied to these forecasts. For without generated power (additional), what is there to transmit (additionally!)</p> <p>We are happy that ERC adopts the Low Mix for the draft determination for the period 2006-2010.</p>	

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Section 2.9 Pages 19-21	Demand Forecasts	NASECORE	As economic performance and population growth remain as the main factors driving the consumption pattern of energy of the country, the DOE Forecast is the best option (Option 1) in forecasting demand as it considered GDP forecasts from NEDA, population growth and electricity demand, and forecasts received from the DUs via the Distribution Development Plan (DDP) as compared to NPC's approach which is based on historical data, and Transco's econometrics approach using GDP as an explanatory variable.	
2.9.3, (p 19)	Demand Forecasts	TRANSCO	<p>TransCo has a separate forecast for individual substations, independent of the DOE forecast. These separate forecasts are used to determine the required transformer capacity in each substation. Additionally, the individual substation forecasts are used to determine the proportions to be applied to the system peak demand in order to determine the substation loadings for load flow purposes. The substation forecasts are based on the non-coincident peak demands. Attachment 3 provides the substation forecast used by TransCo in preparing its Application.</p> <p>Except for Meralco loads, whose size is significantly large that loss of load due to transformer failure would compromise the security of the system, no provision is provided for N-1 for load transformers. Note that the load transformers are classified as connection assets in the amended Connection Charging Policy submitted to the Commission in August 2005.</p>	<p>Refer to substation forecasts contained in attachment 3.</p> <p>Note that except for the Meralco loads, N-1 is not provided for load transformers.</p>
Section 2.10 Page 21	Forecast for Consumer Price Index & Foreign Exchange	NASECORE	<p>We agree with the ERC that the "lowest forecasts for CPI and Foreign Exchange should be used" as the forecast used by TRANSCO/PSALM will "unreasonably inflate the opex and capex costs."</p> <p>Applicants Transco./PSALM will be protected by the TWRG in case the actual CPI and FOREX may differ with the "lowest forecast" as the Price Control Formula for the Second Regulatory Period provides a "Correction Factor" that will allow Transco or its concessionaire to adjust for over or under recovery of revenues.</p>	
Section 2.10.1		NICAI	The ERC states usage of the lowest forecasts for CPI and FOREX but the tabulated values makes no reference to what agency forecast was adopted. Tabulated figures for the U.S. CPI seem to closely fit those of the Access Eco projections and FOREX seems to adopt the EIU estimates however, the Philippine CPI is not benchmarked on any agency. The lowest agency forecast is that of the NEDA. This inconsistency needs to be resolved. Otherwise, the ERC has to come with its own projections and justify its regression analysis.	We suggest using the EIU projections consistently for CPI and FOREX.
		NICAI	TRANSCO's projections for Demand assume linearity of growth and they were able to establish a high correlation of demand over time. ERC's analysis uses geometric calculations of growth rate and the average growth rate was simply determined to form basis of ERC's forecast without any statistical tests to prove correlation over time.	We suggest adopting TRANSCO's linear regression analysis for Demand Projections but to be fine-tuned down to political regions and substation levels so as to be made comparable with Capex projections.

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2.10.1 (p 21)	Forecast CPI, Forex and Demand	TRANSCO	<p>ERC has used the lowest forecasts for CPI and Foreign Exchange. This approach is flawed and appears both arbitrary and biased because:</p> <ul style="list-style-type: none"> <li>- The Commission provides no rationale or basis for its choice of forecasts, other than these are the lowest (and hence most unfavourable to the Applicants).</li> <li>- The use of the lowest forecasts for Philippines CPI, US CPI and forex contradicts with ERC's own criterion to use one consistent set of forecast data (see section 2.5.5.)</li> <li>- The OECD forecast for Philippines CPI adopted by the ERC is already wrong for 2004 &amp; 2005 data</li> <li>- Transco/PSALM exchange rate forecast is based on PPP approach which is an accepted and legitimate forecasting method for medium to long term forward exchange rates in financial modeling and should not be considered as a method which will "unreasonably inflate the opex and capex costs" as claimed by the ERC. In fact, based on our analysis of historical data from 1970, PPP has in effect even under-estimated the true extent of Peso depreciation (see Attachment 1).</li> <li>- The regression analysis shown in Attachment 1 suggests that there is a strong linear relationship between PPP and historical exchange rate, further justifying the use of PPP approach.</li> </ul> <p>The ERC has taken a very optimistic view on the Peso exchange rate forecasts (Peso appreciation against the USD), thereby placing Transco and potential concessionaire at a significant risk if Peso depreciates. Under-estimation of the Peso depreciation will adversely affect the viability of Transco's investment programme and success of the Transco privatization. The PPP approach proposed by the Applicants is an unbiased approach toward exchange rate forecasting and should be adopted in preference to the overly optimistic ERC approach.</p>	Commission should select unbiased CPI and Foreign Exchange forecast series as proposed by the Applicants
2.10.1 (Page 21)	<p>ERC's Approach to Forecast of CPI, FOREX &amp; Demand</p> <p>"ERC feels that the lowest forecasts for CPI and Foreign Exchange should be used as they are all from independent sources and in particular use a lower exchange rate forecast than proposed by TRANSCO/PSALM . ERC is concerned that the</p>	CEPALCO	<p>1. This is inconsistent with ERC's view under Section 2.5.5 which states:</p> <p>"Another issue arises with the TRANSCO/PSALM approach to forecast exchange rate, because the robust development of a forecast revenue requirement from a building block analysis requires an internally consistent view of the forecast time series for the Philippines CPI, the USA CPI and the Peso/US\$ exchange rate. Where these forecasts are taken from inconsistent assumptions, there is likely to more divergence as the reality unfolds, than if the three data sets are drawn from the one consistent set of forecast data."</p> <p>2. We believe that selection of forecast provider should be based on, among others, the integrity and performance of the provider and the reasonableness and consistency of the methodology and assumptions used. It may not be prudent to base our selection of forecast provider on those who can best provide our desired results.</p>	<p>We agree with ERC's view under Section 2.5.5, that if the three data sets are drawn from consistent set of forecasts, there is less likelihood of divergence from actual data. Hence we suggest that the EIU forecasts shall be adopted for the Philippine CPI, USA CPI and Peso/US\$ exchange rate forecasts. As provided in Section 2.8.3 (c) and Section 2.5.6 of the Draft Determination, only the EIU forecast was based on complete and consistent assumptions and analysis.</p> <p>Further, as per Section 2.5.4, the EIU used a more detailed and sophisticated macroeconomic</p>

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
	TRANSCO/PSALM exchange rate forecast will unreasonably inflate the opex and capex costs"			analysis e.g. "input-output" based economy wide modeling, <b>that is why their output is highly regarded within the commercial market place.</b>
2.10.2 (p.21)	Protection provided by MAR formula	TRANSCO	<p>The ERC states that while the actual outcomes are likely to differ from the forecasts used at reset, the primary feedback from actual CPI figures in MAR formula provide significant protection for Transco/PSALM and ensure the primary drivers of changes to opex and capex costs are automatically adjusted on an annual basis.</p> <p>However, many of Transco's costs, particularly capex, have a significant USD component. There is no adjustment to MAR when the exchange rate diverges by +/- 10% from the approved forecast exchange rate. If the potential depreciation of Peso against the USD is under-estimated, it will result in under-estimating the Peso revenue cap required for Transco. In addition, potential Peso depreciation is a key concern for private sector investors in Transco (therefore in the Philippines transmission network). If potential depreciation of Peso against USD is under-estimated, it will impact investors' valuation of Transco, thereby affecting the government's proceeds from the privatization. In the limit, if an unrealistically optimistic scenario for Peso appreciation is used to derive regulated revenues, investors may see the risk of deviation from this as significant and decline to invest.</p>	Because the MAR formula does not protect TransCo for exchange rate divergences of +/- 10%, the forecasts should be an unbiased estimate.
2.10.3 (p.21)	ERC's approach to forecast of CPI, foreign exchange and demand	TRANSCO	<p>The ERC sought additional information on old forecasts so that it can adjust forecasts for any bias identified by the ERC. As noted in comments on section 2.8.4, Attachment 1 provides an analysis of historical accuracy of the PPP as a predictor of Peso/US\$ exchange rate changes. This analysis of historical data since 1970 reveals that PPP has correctly predicted the trend in exchange rate changes, but under-estimated the true extent of Peso depreciation. On the basis of this analysis, any adjustment to the forecast by the Commission should be to anticipate a larger devaluation than predicted by the PPP.</p> <p>However, the Applicants submit that it would not be appropriate for the Commission to modify forecasts (whether those forecasts are determined by the PPP or by independent forecasters). Any such modification would imply that the Commission had better information than the forecasters or new better than accepted theory. The Commission is an expert regulatory body, but not a macro-economic forecasting specialist, and should rely on competent, internally consistent, and independent forecasts.</p> <p>The Applicants were not able to obtain historical comparisons of EIU exchange rate forecasts. On current information, the Commission faces a choice between a set of exchange rate forecasts of unknown accuracy, and an exchange rate series estimated using the accepted economic theory of PPP (which has proven to accurately predict the trend in Peso/US\$ exchange rate since 1970).</p>	<p>The PPP theory has correctly predicted the trend in Peso/US\$ exchange rates since 1970. In the absence of historical information on the accuracy of the EIU exchange rate forecasts (an appreciation in Peso which conflicts with historical experience), the Commission should adopt the accepted theory of PPP for estimating exchange rate changes.</p> <p>The Commission is an expert regulatory body, not a macro-economic forecasting specialist. The Commission should therefore refrain from modifying competent, internally consistent, and independent forecasts.</p>

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Chap. 2, Sec. 2.10.5, page 22	ERC's Approach to CPI, ForEx and Demand Forecasts	FDC - Cebu	basically, demand forecasts figures given by DOE were adopted by ERC as per comparison of Figs. 2.7, 2.8 and 2.9 with Table 2.16	while drivers of the Philippine economy indicate a shift from manufacturing to service industry, ERC must be prudent enough to consider possible vigorous economic activities resulting in opening up of new and pioneer manufacturing industries in Special Economic Zones during the 2 <sup>nd</sup> Regulatory Period that might be energy-extensive
2.10.5 (p 21)	ERC adopts a low mix for the demand forecast	TRANSCO	<p>For the demand forecast ERC is adopting Option 4, commenting that for the last 10 years the drivers of the Philippine economy have shifted from manufacturing to a service industry, which consumes less energy. The Commission has provided no supporting economic analysis for this comment, nor any explanation as to why effects that the Commission says have been evident for 10 years are not already accounted for in the demand forecasts prepared by TransCo.</p> <p>TransCo's forecast assumed macroeconomic assumptions consistent with the NEDA and DOF, and used econometric analysis to produce forecast equations for each grid. This approach would have captured effects the Commission says have been evident for the past 10 years. A very low forecast impacts on the capital expenditure programs. Considering the long gestation periods of projects, there might be problems when demand becomes higher than forecast.</p>	The Commission should adopt the TransCo forecasts as these are soundly based and internally consistent.
2.10.5 (Page 21)	Demand forecast adopted by the ERC	CEPALCO	<p>1. Effectively, the ERC adopted NPC's demand forecasts for Visayas and Mindanao, which used a <b>"trend forecast approach based on historical data"</b> (Section 2.6.1, Page 10). This approach may not be able to capture power requirement in excess of the historical growth rate (e.g., entry of big loads, etc)</p> <p>2. In the planning of transmission lines and substations, it is necessary to make forecasts of the demands in particular areas or regions, rather than for the entire grid and the regional forecasts are used in determining the likely loads on transmission lines and substations over the fifteen-year planning horizon. In addition, the likely development of generation capacities in the different regions over the planning horizon also needs to be formulated. The forecasts of regional demands and generating capacities should also be submitted by the Transco to the ERC for use in evaluating the major projects (costing 50 million pesos or greater) that have been included in the CAPEX Forecast.</p>	1. Suggest to validate this forecast assumption using "Bottom-Up" approach to consider new loads identified by the DUs or as submitted by the prospective loads to the DU.
2.10.5 Table 2.16	Demand Forecast adopted by the ERC	TRANSCO	Based on the data in Figure 2.9 the demand level for Mindanao in year <b>2010</b> should be <b>1,620 MW</b> instead of the 1,610 MW found in Table 2.16.	Correct demand forecast for Mindanao for 2010.
Appendix D (Page 157)	Load Breakdown by Grid	MERALCO	The forecasted load here in Appendix D is very different to the forecasted demand in 2.6.9 or 2.10.5. On what forecast was the CAPEX based on? Can Transco provide a load breakdown based on their 2006 TDP load forecast?	For clarification

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Chapter 3				
	General Comment	LAPOCOF	<p>Essentially, we agree to the process that the ERC is segregating the connection assets from the network assets and optimizing the Capital Expenditure forecasts before becoming part of the Regulatory Asset base</p> <p>In the Mindanao Grid, there is being built a new 230 kV transmission line backbone. The rationale and justification of this new extremely High Voltage line has yet to pass ERC approval. LAPOCOF is of the position that those CAPEX that have not passed the approval process should not be included in the RAB. Moreover, the CAPEX review process should be transparent such that public hearing shall be called thereon where parties of interest are allowed to file comments and participate in the Public Hearing.</p>	
Chapter 3 (Page 23)	Capital Expenditure Forecasts General Comment: on CAPEX line-up Determination	MERALCO	<p>An assumption is made that the submitted CAPEX of Transco satisfies reliability and economic objectives without any bias against any industry participant. The submission does not specify the problem to be solved and the alternatives considered in coming up with the proposal. Other countries apply what is called the “Grid Investment Test” to qualify their projects.</p> <p>Note: If ERC agrees to a “Grid Investment Test” of CAPEX, the same may be applied to Meralco’s CAPEX.</p>	ERC should come up with a “Grid Investment Test” document to qualify proposed CAPEX projects.
3.1.1 (p 23)	Approach to capital expenditures	TRANSCO	<p>The Commission refers to the general principles provided in section 4.4.1 of the TWRG and the declaration of policy in section 3 of the EPIRA. Section 4.4.1 states that the ERC “must reasonably compensate the Regulated Entity for the economically efficient costs and risks it incurs in providing Regulated Transmission Services ...”</p> <p>The Applicants submit that the Draft Determination fails to comply with this principle as the Draft Determination rejects forecasts of economically efficient costs and risks that will be incurred by TransCo in providing Regulated Transmission Services. The economically efficient capital expenditure forecasts excluded by the Commission are detailed below</p>	The Draft Determination excludes economically efficient costs and hence breaches the general principles set out in section 4.4.1 of the TWRG.
3.1.2 (p. 23)	Review by Independent Expert	TRANSCO	<p>The ERC refers to requirement for the Regulated Entity to retain an independent expert to review the capital expenditure forecasts. TransCo retained (through its adviser) SKM to review the capital expenditure forecasts. The SKM report was attached as Annex D to the Application. SKM concluded that the capital expenditure forecasts submitted by the Applicants is reasonable and in particular the forecasts are:</p> <ul style="list-style-type: none"> <li>• “Represented fairly in discrete projects</li> <li>• Based on best available prices obtainable from international markets</li> <li>• Reasonably efficient from design and implementation points of view</li> <li>• Sufficient to support forecast growth in customer connections, coincident peak demand and energy delivered</li> <li>• Sufficient to allow TransCo to achieve or exceed the target levels of performance.” (page 1)</li> </ul>	The Commission appears to have considered irrelevant matters and not to have given due consideration to relevant matters. The draft decisions are therefore unreasonable and should be reviewed.

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
			<p>Section 4.10.5 of the TWRG requires the Commission to consider the experts report and decide whether the capital expenditure program is:</p> <ul style="list-style-type: none"> <li>• Based upon the best available prices obtainable from international markets.</li> <li>• Is likely to support forecast growth in customer connections, co-incident peak demand and energy delivered.</li> <li>• Sufficient to allow the Regulated Entity to achieve or exceed the target levels of performance.</li> <li>• Based on reasonable PHP/US\$ exchange rate and CPI forecasts.</li> </ul> <p>If the ERC decides that these conditions are met, it <b>must</b> approve the expenditure program proposed by the Regulated Entity. If it decides that these conditions are not met, it must after consulting the Regulated Entity, approve forecasts amended so as to ensure the conditions specified above are met. (see section 4.10.5) The TWRG does not provide for the ERC to reject or amend the forecasts for any other reason.</p> <p>The Draft Determination does not describe the Commission's review of the experts report, or explain the reasons and basis of any view that the expert was wrong in his conclusions. The Draft Determination does however reject aspects of the Applicants' proposed expenditure program for reasons not included in the decision criteria specified in section 4.10.5 of the TWRG. In particular, the ERC proposes to exclude capex projects which are payments for right of way or are ongoing but do not have prior approval from the ERC.</p> <p>On the basis of the Draft Determination, the Commission appears not to give due consideration to relevant criteria (the experts report) and to have considered irrelevant criteria (whether the projects had prior approval). The draft decisions are therefore unreasonable.</p>	
3.3.1 (p. 23)	CAPEX which underwent construction without prior approval from the ERC	TRANSCO	<p>Constructing a project without prior approval from the ERC is not a valid reason under the TWRG for excluding future costs of the project from the capital expenditure forecasts. Section 4.10.5 defines the basis on which the ERC may amend the capital expenditure forecasts. If TransCo has breached the EPIRA, any such breach should be addressed under the relevant provisions of the EPIRA. Rejecting economically efficient capital expenditure forecasts, to punish TransCo for a purported breach of the EPIRA, risks inflicting a deteriorating service on customers.</p> <p>In addition, the Commission's list of projects completed or ongoing without approval (Table 3.4) contains errors. It includes projects implemented prior to the EPIRA. Other projects are the subject of the "show cause" order of the ERC. Please refer to comments on Section 3.14 for the list of these projects.</p>	Projects excluded because they were implemented without ERC approach should be added back to the capital expenditure program.

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
	General comment on ERC approval for capital expenditure projects	TRANSCO	<p>As noted above, the Applicants submit that the TWRG does not allow the ERC to exclude forecast expenditure on economically efficient capital expenditure projects on the basis that they were commenced without prior approval from the ERC. The Commission’s comments, however, raise a more general issue about how the Commission interprets Section 9 of the Electric Power Industry Reform Act of 2001 (EPIRA) in relation to the capital expenditure forecasts that will be approved under section 4.10 of the TWRG for the Second Regulatory Period. Section 9 of the Electric Power Industry Reform Act of 2001 (EPIRA) provides that “TRANSCO shall submit any plan for expansion or improvement of its facilities for approval by the ERC”.</p> <p>There would appear to be two possible interpretations of Section 9 of the EPIRA with regard to capital expenditure forecasts approved by the ERC under section 4.10 of the TWRG:</p> <ul style="list-style-type: none"> <li>• The first interpretation is that the capital expenditure forecasts and supporting information (including the review by independent expert) submitted by TransCo to the ERC under section 4.10) constitute a “plan for expansion or improvement of its facilities”. Hence approval of that plan (as modified by the ERC) by the ERC satisfies the requirements of Section 9 of the EPIRA.</li> <li>• The second possible interpretation is that the capital expenditure forecasts do not constitute a plan for expansion or improvement of TransCo’s facilities and hence TransCo is required to seek an additional approval for each project.</li> </ul> <p>The Applicants submit that the first interpretation is the correct interpretation for the following reasons:</p> <ul style="list-style-type: none"> <li>• The practical reality is that the capital expenditure proposed by TransCo is a plan to expand or improve its facilities. If the proposed capital expenditure is approved, TransCo will commence or complete projects that will result in expanded or improved facilities.</li> <li>• To require TransCo to re-submit each project individually would result in duplication and waste of the Commission’s resources and the sources of TransCo and other stakeholders. The TWRG establishes sufficient safeguards to ensure that the Commission approves only economically efficient projects to expand or improve transmission facilities.</li> <li>• Requiring separate and additional approval for each project would be inconsistent with the objectives of performance based regulation. The TWRG provides TransCo with scope and incentive to manage its capital expenditure to deliver service levels to customers as efficiently as possible (see Article 9 of the TWRG). Micro-management by the ERC of the implementation by TransCo of the capital expenditure plan approved under section 4.10 of the TWRG would dull or remove these incentives.</li> </ul> <p>The Applicants request that the ERC clarify its interpretation of the requirements of Section 9 of the EPIRA in the context of a capital expenditure plan approved by the ERC under section 4.10 of the TWRG.</p>	Clarify that a capital expenditure plan approved by the ERC under section 4.10 of the TWRG satisfies the requirements of Section 9 of the EPIRA.

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Section 3.3.1		NICAI	We do not agree fully to ERC's approach that projects which have not been duly approved by the ERC be excluded from the Rate Base. It is the ERC's responsibility to facilitate evaluation of such projects and if delays are incurred on the part of regulation, the regulated entity should not be made to bear the consequences. Some of the listed projects have undergone GMC scrutiny and have been favorably endorsed in the past months to resolve voltage issues and bulk transmission requirements from one node to another while making sure the N-1 criterion is met( We cannot compromise on this criterion).	
Section 3.4 Page 29	Capital Projects that Underwent Without Prior ERC Approval	NASECORE	Any capital projects that were undertaken by Transco without the required approval of the ERC should not be included in the computation of transmission rates or allow Transco or its concessionaire to recover the costs in the transmission rates. The ERC should also penalize the Transco management for their failure to submit these 21 transmission upgrading projects worth PhP16.991 Billion for its approval.	
Chap. 3, Sec. 3.4.1 and 3.4.2 (vis-à-vis), page 23	Projects Which Seeks to Reduce Constraints (CapEx Forecasts)  Approach to CapEx Forecasts	FDC - Cebu	compliance to an optimum N – 1 level would further reduce constraints in the grid system but such would necessitate additional transmission infrastructure sufficient to address load demand	evaluation must be conducted on the possible N – 1 compliance on the 500 KVA and 230 KVA lines but such would mean a programmed capital projects that may be carried during the 2 <sup>nd</sup> Regulatory Period
3.4.1 (p. 23)	Projects which seek to reduce constraints	TRANSCO	Applicants are confident that the capex projects are prioritized in a way that will effectively address potential constraints in the system. In fact, the TDP has identified the projects that will relieve the constraints in the Luzon, Visayas, and Mindanao grids. In Luzon, the on-going projects, particularly the Batangas Transmission Reinforcement Project, intend to augment the existing facilities to address the existing constraints. In the Visayas, all such projects are currently on-going, except for the Northern Panay Backbone which is ranked as Priority 1. In Mindanao, on the other hand, three (3) of such projects are on-going. These projects are listed in Tables 6.3.1, 6.3.2, and 6.3.3 of the TDP, and are attached hereto as Attachment 4.	
Section 3.5.1 and 3.5.2	Approach to Network Planning – Balance between Generation and Transmission Investment	LAPOCOF	TRANSCO relies in DOE while DOE relies on the Distribution Development Plan (DDP) of each Distribution Utilities (DU). This is the framework by which overall DDP and PDP (Power Development Plan) of DOE are established. All of these are per EPIRA.  The DDP 2004-2012 underwent the EPIRA prescribed process and so the various Distribution Utilities (134) comprising of 117 electric cooperatives (EC's) 16 private investor-owned utilities (PIOUs) and 1 Local Government Unit- Owned utility (LGU-OU) participated in the submission of their DDP's (See Table 1. DDP Submission Rate of DU's), page 4 (see attachment A) of DDP-2004-2012.	We wish ERC will consider all points as presented!

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)																				
			<p>The basic issues on the DDP are:</p> <ol style="list-style-type: none"> <li>How extensive and reliable are the DDP's of each DU?</li> <li>Had the methodology in complying and submission of DDP is formulated by JICA and DOE been truly exhaustive and realistic.</li> <li>How sincere were the complying of the requirement of DOE? Did they fill-up the DDP form realistically or just for the purpose of complying.</li> </ol> <p>Please take note that at the bottom of page 3 of DDP2004-2014, (see attachment B) the paragraph states;</p> <p>The plan used the <u>assumption</u> that the DU's strictly observed and complies with the guidelines prescribed in the PDC in preparing the DDP. Most importantly, the plan serves only as <u>indicative</u> DDP of each DU's.</p> <p>Please note the words <u>assumed and indicative!!!</u></p> <p>Its in the area of the formulation of the DDP of each DU's that we ask ERC to look into how DOE validated in the strict sense of the word the submitted DDP of each DU's which became the basis of DOE's PDP and DDP. The bottoms up approach is laudable, only when proper safeguards, controls and <u>actions</u> are put in place!!!</p> <p>Another major item which we want to point out:</p> <p>In PDP 2005-2014, Mindanao Power Development Plan, under subsection Capacity Mix and Supply Interdependence pp. 29-30 (see attachment C)</p> <p>Mindanao's total installed capacity as of September 2004 stood at 1,665.3 MW with a dependable capacity of around 1,402MW (Figure 5-1). The breakdown by resource level shows that the region is primarily dependent on hydro at 998 MW (59.9%) and oil-based plants at 559 MW (33.6%). The balance came from geothermal resources at 108 MW (6.5%). Total generated power in the region in 2003 was 6496 Gwh, 62% of which was attributed to the hydro generation of the AGUS hydro complex. Other resources that contributed to the balance came from oil-based plants (25%) and geothermal plant (13%). Compared to region's 2002 level, about 14MW of mostly oil-based plants were installed in 2003 to meet the growing demand in the region. While there is an apparent surplus capacity of about 131 MW for the entire region in 2004, some areas suffer supply deficits relative to the other areas due to issues related to resource and transmission constraints. This necessitates the conduct of separate analysis for the North, South and western sections of the Mindanao region.</p> <p>Interpolating on the total generated power for 2003, the average MW contribution were:</p> <table border="1" data-bbox="684 1287 1577 1425"> <thead> <tr> <th></th> <th>Installed Capacity</th> <th>Share</th> <th>Average MW used</th> </tr> </thead> <tbody> <tr> <td>Hydro</td> <td>998</td> <td>62%</td> <td>619</td> </tr> <tr> <td>Oil</td> <td>558</td> <td>25%</td> <td>140</td> </tr> <tr> <td>Geothermal</td> <td>108</td> <td>13%</td> <td>14</td> </tr> <tr> <td></td> <td>1664MW</td> <td></td> <td>773MW</td> </tr> </tbody> </table>		Installed Capacity	Share	Average MW used	Hydro	998	62%	619	Oil	558	25%	140	Geothermal	108	13%	14		1664MW		773MW	
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			<p>The simplistic approach shows that on the installed capacity of 1665.3MW (Sept 2004), the actual average utilization was only <u>46%</u>.</p> <p>Mindanao is divided into three (3) major systems group with North Mindanao having the most total generation capacity of 1,220MW with only 534MW peak demand. Thus North Mindanao exports the excess power to South Mindanao and west Mindanao.</p> <p>It must be well considered however that these peak demands of the 3 major systems are being well served by existing transmission lines. The constraints are not in the transmission capacities, the constraints are in the generation capacities in the two regions. There are no real justifiable reasons for putting up new transmission infrastructures then.</p> <p>If reliability, peace and order are the reasons for putting up redundant lines, no amount of technological and financial solutions will suffice for social problems as of the moment Mindanao Transmission lines can adequately serve the needs even up to 2010.</p> <p>Lastly, we want to point out that in Mindanao, after 2007 there is no committed power plant to be installed. This is shown in Figure 5-3, Mindanao Supply and Demand Profile, page 32 (se attachment D) of the Power Development Plan, 2005-2014.</p> <p>Also during the presentation of Hon. Cyril C. Del Callar, President of NPC during the forum conducted by NPC in Iligan in Nov. 29-30, he confirmed the non-installation of new generating capacities base on the handout "NPC/TRANSCO measures in Mindanao, page 4 where for the period 2005-2006, the only additional capacities aside from the commissioning of Mindanao Coal in 2006, are the transfer of Power Barges, the completion of Baloi Flood control project and the desiltation/dredging of Pulangi. (see attachment E page 4)</p> <p>In the demand determination, Table 2.16; ERC adopts for Mindanao the Low Mix Option. We are glad. May we point out that in the DOE-Power Development Plan.2005-2014 Figure 5.1 Mindanao Supply Interdependence page 30 (Mindanao Power Supply Demand Outlook), the dependable capacity as of 2004 is 1402MW.</p> <p>With the coming in of Mindanao Coal (200MW) by 2006, the dependable capacity would then be 1602MW. This is almost the same figure (1610MW) that ERC is using for Mindanao Demand Forecast for 2010. And Transco had stated that it has the Transmission capabilities for these installed capacities!</p>	
3.5.1 and 3.5.2 (p. 24)	Balance between Generation and Transmission Investment	TRANSCO	<p>The Draft Determination asserts that Applicants "relies solely on the Philippine Development Plan (PDP) prepared by the Department of Energy (DOE). That statement is not correct. TransCo does not rely on the DOE's PDP alone to integrate generation planning with the TDP. TransCo, as a matter of policy to address system reliability and security, undertakes System Impact Study (SIS) for proponents on new generating plants. The SIS is intended to determine the adequacy of the existing network to accommodate the connection of new generators. Understandably, the investors for these generation projects would like to be assured that their plants will be fully dispatched, hence the need for SIS. The SIS is a requirement of the Grid Code.</p>	

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			<p>Since being separated from NPC, TransCo has completed the SIS for the following generating plants:</p> <ol style="list-style-type: none"> <li>2. Northwind (Ilocos Norte)</li> <li>3. PNOC Wind Power (Ilocos Norte)</li> <li>4. PNOC Geothermal Mambucal-40 MW (Negros)</li> <li>5. PNOC Geothermal Pal-Opti -20 MW (Negros)</li> <li>6. San Carlos City-Smith Bell (Wind)</li> <li>7. Bronzeoak Bioenergy (Negros)</li> <li>8. Talisay Bioenergy (Negros)</li> <li>9. CEMEX Power (Cebu)</li> <li>10. KepCo Coal Plant (Cebu)</li> <li>11. KepCo Coal Plant (Panay)</li> <li>12. Enervantage Power (Panay)</li> </ol> <p>On-going SIS includes the following:</p> <ol style="list-style-type: none"> <li>1. PNOC Mt. Apo Geothermal (Mindanao)</li> <li>2. PNOC Cabalian Geothermal (Leyte)</li> <li>3. San Carlos Ethanol (Negros)</li> <li>4. VECO Embedded Plant</li> </ol> <p>Clearly, those generating plants, not included in the PDP are integrated into the transmission planning through the conduct of the SIS. The grid reinforcement, if any, necessary to accommodate the proposed connection however, shall be included into the TDP depending on the commitment of the proponent to pursue the project.</p> <p>On the potential location of generation plant, choosing a site for a new power plant is an important part of electric system planning. The TDP identifies the ideal sites where incoming generators can connect with minimal grid reinforcement necessary. These sites are identified in the course of integrating into the transmission planning those indicative (without specific locations) generation additions in the PDP. Identifying these connection points would lead to the optimized utilization of available transmission capacity that would ultimately result in more prudent capex program.</p> <p>Ideally, for maximum reliability and economy it is desirable to have the generating unit(s) installed closer to the load center it will be serving, but this is seldom possible, as TransCo does not decide on where a new plant proponent will locate its facilities. For one, there are power plants that are site-specific, e.g., hydro, geothermal, wind, mine-mouth coal plant, among others. While TransCo can recommend the ideal connection points as what was done in the TDP, the other requirements that must be taken into account when siting a non site-specific power plants are: (a) fuel supply/transport; (b) topography/geology of site; (c) accessibility; (d) availability of area; (e) harbor condition; (f) availability of cooling water; (g) fresh water supply; (h) security; and (g) environmental/social concerns. These factors limit the flexibility of locating the power stations. The introduction of nodal pricing under the WESM will provide additional price information to generators in terms of the best location for plan.</p>	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
			<p>TransCo cannot force a generator company to locate at specific locations that would require less capital investments. However, incentives exist for generation and transmission to co-optimize. Before generators construct their facilities, they look for locations that would not require any major transmission line reinforcement because any constraint would mean undispached or stranded capacity, which translates to lost revenue opportunity. In other words, it is in generators best interest to locate generating units at locations not requiring much transmission reinforcements. Other impediments (to generator siting) aside, generators would rather build plants near load centers to minimize expenses.</p>	
3.5.2 (Page 24)	Balancing the development of both the generation and transmission sector	CEPALCO	<p>During the hearings, the Transco have stated that they are not responsible for forecasting of supply of electricity and that they have considered the supply forecasts in the Philippine Energy Plan of the Department of Energy in making the Transmission Development Plan. The Transco need to show that the TDP is based on the most likely development of generating capacities in the different regions. The “most likely” development of generation plants is the Least-Cost option over the planning horizon, considering the costs of the generating plants and the transmission facilities needed to bring supply to the loads, and considering also the Demand Resources (primarily energy efficiency projects) that should be developed over the planning period. It is not enough for Transco to consider the forecasts of supply by the DOE or other parties; they should carry out with the DOE the joint planning of supply and demand resources, and formulate the Least-Cost Plan over the planning horizon. It is this Least-Cost Plan of Supply and Demand Resources that should then be used in formulating the TDP</p>	
3.10.1 (p. 26)	Optimized capex forecast	TRANSCO	<p>The Independent Expert was from the same firm that carried out the optimization and revaluation of the RAB. Hence the expert was familiar with the principles and approach taken in the optimization and revaluation of the RAB and applied the same principles and approaches in reviewing the capital expenditure forecasts.</p> <p>The Independent Experts undertaking the revaluation reviewed substation designs, feeder configurations, and transmission voltage levels in producing an Optimized Depreciated Replacement Cost valuation. The optimization to remove any excess capacity or over-design, amounted to approximately 3.5% of the total network replacement cost. This indicates that the network design is reasonably efficient.</p> <p>A number of specific proposed were reviewed by the capex Expert to provide comfort that the historical efficiency reflected in the optimization results was being carried forward in future project designs. A sample of projects included in the forecast were selected, and the designs were reviewed and found to be reasonable and not “over-designed” or “gold plated”.</p>	
{Par. 3.10 p. 26	Optimization of Capex Forecast	LAPOCOF	<p>LAPOCOF is agreeable to the optimization process made in the Capital Expenditure Forecast. The optimization process will allow review for over-design, too much redundancy and overcapacity specification, which really intended for future customers. The RAB and Capex must be reviewed for this phenomenon because it will mean that the present customers are paying for the facilities for future customers.</p> <p>The optimization process should only limit to the 5-year regulatory period the planning horizon for evaluating the ODRC and the Capex to be included in the RAB</p>	

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Chapter 3.10.1 (Page26)	Optimization of CAPEX Forecast (re: Judging whether the forecast CAPEX of Transco is efficient or not.)	MERALCO	In Figure 3.2 which shows the Basic Optimization Approach, the criteria used in testing for efficiency (“Is the line or substation required now?”) are not explicitly explained.  What percentage loading is acceptable to ERC before saying a line or a substation is needed? Is the N-1 criterion the only one applied?	ERC should explain the criteria or rules when a line or substation is required so that Transco or Meralco (for DWRG) can already comply with those criteria and avoid a potential rework on its CAPEX forecast later.
Section 3.12.3 (Page 28)	Transco/PSALM's Treatment of Connection Asset	MERALCO	The section says that the total number of capital projects is 73. However in Table 3.3 which the section refers to, the total number of projects is only 72 (i.e., 25+37+10 = 72). There seems to be a missing project in Table 3.3 because Table 3.6, which should reflect the same projects after ERC’s re-classification, also shows a total of 73 projects.	For clarification
3.14	Capital Projects that Underwent Without prior ERC Approval	TRANSCO	<p>The following discussions will comment on the projects listed in Table 3.4 of the Draft Determination. The projects are grouped into: (1) Projects which were started prior to EPIRA; (2) Projects which are the subject of “show cause” order by the ERC; and (3) Projects whose documentary requirements are being offered in compliance with the EPIRA requirement:</p> <p>Group 1: The following projects listed in Table 3.4 were started prior to EPIRA as can be seen from the NEDA Board (NB) approval dates:</p> <ol style="list-style-type: none"> <li>1. Batangas Transmission Reinf. Project 12/97 NEDA Approval</li> <li>2. Bunawan Substation 2/93 NEDA Approval</li> <li>3. Calaca II Asso. T/L (Completed prior to EPIRA)</li> <li>3. Leyte-Cebu Exp/Uprating Proj. 12/97 NEDA Approval</li> <li>4. Leyte-Samar Reinf. 69/138KV Proj. 12/95 NEDA Approval</li> <li>5. Luzon Cluster C S/S Exp. 11/94 NEDA Approval</li> <li>6. Negros III Transmission 12/95 NEDA Approval</li> <li>7. Negros V Transmission 12/95 NEDA Approval</li> <li>8. Panay IV Transmission 12/95 NEDA Approval</li> <li>9. Zamboanga City 138 KV 11/98 NEDA Approval</li> <li>10. Maco Substation 5/95 NEDA Approval</li> </ol> <p>Prior to issuance of NB Approval, pre-construction activities such as survey and social acceptance had been completed, and the Regional Development Council (RDC) approval and Environmental Compliance Certificate (ECC) had been secured.</p> <p>The NB Approval is the final phase in the multi-stage approval process of the Investment Coordinating Council (ICC). The first stage is the endorsement of the ICC Secretariat (NEDA) along with the endorsement of the Department of Finance. The ICC-Technical Board comes next, headed by the NEDA Assistant Director General, with the Undersecretaries of selected Departments as members (DOE is a permanent member). The next stage is the ICC-Cabinet Committee chaired by the DOF Secretary, with NEDA Director General as co-chair and with different Department Secretaries as members.</p> <p><b>It should be noted that the NEDA Board is chaired by the (incumbent) President of the Philippines with the NEDA-Director General as Vice-Chair.</b></p>	We suggest that ERC to promulgate the Guidelines to effectively implement the intention of the Rules Implementing the EPIRA specifically Section 4 (c) Rule 3.

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			<p>What TransCo indicated thereat are dates of NEDA Board approval, which basically signals the implementing agency, in this case TransCo, to arrange, secure or scout financing.</p> <p>Group 2: These projects are the subject of "show cause" order from the ERC and that hearings were conducted on them.</p> <ol style="list-style-type: none"> <li>1. Batangas Transmission Reinf. (Dec. 23, 2004)</li> <li>2. Bauang-San Esteban L2 Stringing Project (Nov. 19, 2004)</li> <li>3. Cebu-Negros Interconnection Uprating Project (Dec. 8, 2004)</li> <li>4. Gen.Santos-Tacurong 138 KV T/L (Nov. 19, 2004)</li> <li>5. Leyte-Cebu Interconnection Uprating (Dec. 23, 2004)</li> <li>6. Leyte-Samar Reinforcement Project (Dec. 23, 2004)</li> <li>7. Negros-Panay Interconnection Uprating Project (Dec. 8, 2004)</li> </ol> <p>Other projects (with date of submission to ERC) in the 'show cause' order are:</p> <ol style="list-style-type: none"> <li>1. Binga-San Manuel 230 KV T/L Upgrading (Dec. 8, 2004)</li> <li>2. Cebu-Mactan Interconnection Project (Dec. 8, 2004)</li> <li>3. Luzon Transmission Line Upgrading (Dec. 8, 2004)</li> <li>4. Leyte-Bohol Interconnection Uprating, Stage 2 (Dec. 23, 2004)</li> <li>5. Mindanao Substation Expansion Project 2004 (Nov. 19, 2004)</li> <li>6. New Gamu Substation (Nov. 21, 2005)</li> </ol> <p>Among the important information included in TransCo's submission for the 'show cause' Order include:</p> <ol style="list-style-type: none"> <li>a. Description of the projects;</li> <li>b. Reason(s) for the projects;</li> <li>c. Historical planning data;</li> <li>d. Technical analysis (simulation and/or computations);</li> <li>e. Financial and economic analysis, which include detailed computation of the Net Present Value Internal Rate of Return, and Benefit/Cost Ratio.</li> </ol> <p>Group 3: TransCo is also submitting the pertinent documents for the following projects and these are covered in Attachment 5:</p> <ol style="list-style-type: none"> <li>1. Lahar-Affected T/L Relocation Project</li> <li>2. Abaga-Kirahon 230 KV T/L Project</li> <li>3. Visayas Capacitor Project 1</li> <li>4. Wright-Calbayog 138 KV T/L Project (Turnkey)</li> <li>5. Binan-Dasmarinas</li> </ol>	

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			<p>The ERC has yet to finalize the guidelines on evaluation and approval of capital expenditures of transmission and distribution utilities which we believe will be the basis of TransCo's submissions and will provide further guidance to TransCo as to the ERC's requirements. As noted above, the Applicants submit that approval by the ERC of capital expenditure plans under section 4.10 of the TWRG would satisfy the requirements of Section 9 of the EPIRA, for proposed capital expenditure in the Second Regulatory Period</p> <p>The noted earlier, constructing a project without prior approval from the ERC is not a valid reason under the TWRG for excluding future costs of the project from the capital expenditure forecasts. The Applicants note that the ERC does not appear to have considered the impact of the system should the projects listed in Table 3.4 be excluded from the Capex program and not completed:</p> <ol style="list-style-type: none"> <li>1. <u>Cebu-Negros Upgrading</u>: Peak load to date of Cebu-Negros (100 MW capacity) is 88 MW. If the upgrading (additional 100 MW) is not be implemented, the link will be overloaded by around 65% starting 2008.</li> <li>2. <u>Cebu-Leyte Upgrading</u>. Peak load to date of Cebu-Leyte is 324 MW. Prior to the recent completion of the upgrading (now 400 MW), this submarine link had a capacity of only 200 MW.</li> <li>3. <u>Negros-Panay Upgrading</u>. Peak load to date of Negros-Panay (100 MW capacity) is 76 MW. Without the upgrading, the link will be overloaded by as much as 25% in late 2006.</li> <li>4. <u>Batangas Transmission Reinforcement Project</u>. In Luzon, the remaining congestion is in the southern part preventing the full dispatch of the natural gas plants in the area. This project aims to provide additional path where the generation from the South Luzon would flow, particularly the natural gas power plants, to allow maximum dispatch of these plants.</li> </ol> <p>TransCo would not de-activate or shutdown these lines just to show how they would impact on the network and thus demonstrate the justifications for these projects. The results of TransCo's studies, as now proven and validated by the system conditions, serve as a strong evidence of the necessity of the completed and going projects.</p> <p>In the case of Panay-Boracay Interconnection Project (also included in Table 3.4), TransCo has a pending application for approval on this project with the ERC. As this has been classified by TransCo as connection asset, TransCo and AKELCO are currently finalizing the Lease-Purchase Agreement for the submarine cable. However, ERC, in the Draft Determination, has classified the said line as network asset.</p>	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
3.14.2, (Page 29)  5.17, (Page 75)	Capital Projects that Underwent Without Prior ERC Approval  Options for Treatment of RAB	CEPALCO	CAPEX implemented after June 2001 without prior ERC approval were excluded in the Draft Determination.  Included only those CAPEX amounts for CAPEX projects approved prior to the commencement of the EPIRA which incurred expenditure in 2005 (Sec. 5.7.1 (c))	<ul style="list-style-type: none"> <li>- Existing assets and capex forecast that pass the basic optimization principles and approach <b>should be included in the RAB.</b></li> <li>- ERC approval on such capex may become incidental when the assets are included in the optimized network after subjecting the asset to optimization test.</li> <li>- TRANSCO may be sanctioned separately for its non-compliance with the pertinent provisions of the EPIRA and its IRR in accordance with Section 43 (l) of the EPIRA.</li> <li>- Excluding these projects could put at risk the financial viability of the Transco.</li> </ul>
3.16 (p.31)	Treatment of Connection Asset  3.16.1 SKM has represented that they are using the TWRG definition of Connection Asset (that connection assets are assets which are “not shared” and are “dedicated” to one customer) and have used the overseas approach to meet this definition.  3.16.2 (a) TRANSCO was including both 'deep augmentation' assets as well as 'shallow augmentation'	TRANSCO	Refer to SKM Report Volume A, Appendices J to N and Volume B  Except for brief discussions in Section 1.3 – Definitions, the TWRG does not indicate the type of connection charging it intends to prescribe under a PBR. Neither are the concepts of 'deep augmentation' nor 'shallow augmentation' been discussed in the TWRG. Thus, <u>there is nothing substantial</u> from the TWRG from which TransCo could align its proposed Connection Charging Policy (except that the Transmission Connection Services shall be regulated until the commencement of the Second Regulatory Period).  For clarity, please provide a reference to the 'ERC policy' mention in Par. 3.16.2 (a) and the clauses in the TWRG relied on by the ERC.	We request the Commission to look into the two (2) Connection Charging Policy submitted by TransCo. One in December 2003, which is a shallow connection policy and the August 2005 submission which is a deep connection policy. TransCo will highly appreciate if the Commission will, at this point in time declare its exact position on the submission. This will guide TransCo should there be amendments/revisions on the Connection Charging Policy

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	<p>assets as connection assets (this appears not to align with ERC policy and is not a feature of the TWRG or other PBR systems) and ERC in the public consultation process for the TWRG previously indicated this was not the intention.</p>			
	<p>(b) TRANSCO is including what appear to be meshed network assets which feed a group of coops / DUs as connection assets (even where they are obviously shared on the line diagram) and lump the <b><u>whole step down transformer</u></b> into the connection definition, whereas it is usually only from the breakers on the low voltage side which would be considered as connection.</p>	TRANSCO	<p>This suggests the ‘deep augmentation’ nature of the proposed policy but this can be explained by TransCo’s attempt to make the connection charging fully account, consistently, for the costs that directly benefit a particular user or a specified group of users (similar to the Connection Charging Policy of the UK’s National Grid).</p> <p>This is in pursuance of minimizing, if not completely eliminating, cross-subsidies among customers, which supports the intention of the EPIRA. If the transformer, in this case, will be considered as network asset, then it does not reflect the actual utilization of the transformer. In case a particular customer accounts for say more than half of the load of the said transformer, that particular user is being subsidized by the rest of the customers (through power delivery service charge or PDS) inasmuch as the connection charges being imposed on that user do not include the “network” transformer.</p> <p>TransCo believes that the approach taken by TransCo is far from “deep” connection policy. Under the conventional definition of a ‘deep’ connection charge, where a new generation plant is charged the full cost of reinforcement anywhere on the system deemed necessary by the transmission provider to allow the system to transmit the generator’s output consistent with the transmission system planning standards.</p> <p>The Draft Determination suggests that the ERC intends to classify transformers as network assets and not as connection assets. However, there are projects in Appendix A, Table A.3, that involve installation of transformers (Luzon Substation Expansion Projects 1 &amp; 2) which TransCo believes are classified by ERC as Connection capital projects. TransCo seeks clarification as to whether all assets from the transformer up to the high voltage network will be classified as network assets by the ERC..</p>	

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	(c)TRANSCO classifies the subsea interconnectors as connection assets to the islands which are importing the electricity through this link, which the ERC does not believe is economically efficient, when translated into a connection price.	TRANSCO	<p>The classification proposed by TransCo is based on “users’ pay” principle. Why should the customers in one island pay for the submarine cable when that link is being used to supply the power requirements of the other island? This approach is consistent with the principle of imposing the charges to those who benefit from the asset.</p> <p>TransCo seeks clarification on the classification by ERC of Cebu-Mactan submarine cable as connection asset, and the Panay-Boracay as network asset. While the ERC appears to suggest that sub-sea interconnectors should be treated as network assets due to economic considerations, the different classifications of these two submarine links seem to give conflicting signal on the ERC’s basis of such classification.</p>	
	(d)TransCo does not appear to be applying its definition of connection assets consistently, as if the classification is being left up to a number of business divisions, which are applying different rules.	TRANSCO	TransCo has applied a consistent definition. There is a Technical Working Group specifically tasked to draft TransCo’s proposed Connection Charging Policy and there is no truth to the purported application by TransCo of different rules. The existing facilities and even the CAPEX projects were classified consistently based on a single policy, i.e., TransCo’s proposed Connection Charging Policy. The Applicants seek clarification from the ERC with regard to the basis for its statement.	
3.16, (Page 31)	Treatment of Connection Asset	CEPALCO	<p>ERC noted inconsistency in TRANSCO’s classification of Connection Assets. (Section 3.16.2 – d, page 31)</p> <p>ERC’s reclassification of Connection Asset is as itemized in Appendix A, pages 130 –134</p> <p>The Transco is proposing a definition of Connection Assets that would include the substations and lines that have been classified (by Transco and the ERC) as Sub-transmission Assets, and which the EPIRA decreed should be sold by the Transco to qualified distribution utilities. If the definition proposed by the Transco were followed, it would give them a means for circumventing the EPIRA requirement for the disposal by Transco of Sub-transmission Assets.</p>	<p><b>Connection asset classification</b> to be applied in TWRG, Connection Charging Policy, and OATS should be consistent in accordance with the ERC Guidelines for the Sale and Transfer of TRANSCO's Sub-transmission Assets, which was promulgated in accordance with EPIRA.</p> <p>We suggest the following definition of Connection Assets:</p> <p>“Connection Assets consist of the facilities used to connect users of the Grid to the transmission system, but shall not include power transformers</p>

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				<p>and their accessories, nor include entire sub-transmission lines, and will be limited to the last section of conductors that connect the user to a substation or to a sub-transmission line, along with the switching and control facilities, metering equipment, and the monitoring and protective facilities for the connection to the user.</p> <p>Where a Connection Asset is at the end of sub-transmission line, the Connection Asset shall consist of the set of conductors emanating from the last pole or tower and terminating at the mechanical point of connection to the pole or tower of the transmission line.</p> <p>Where a Connection Asset is connected to a Transco substation, the Connection Asset shall consist of the set of conductors that connect to the substation, starting at the mechanical point of connection to the first tower or pole adjacent to the substation, or to the mechanical point of connection to the user facilities where this is adjacent to the Transco substation.”</p>
Chapter 3.16 (Page 31)	Treatment of Connection Asset	MERALCO	<p>TWRG’s definition of Connection Asset as quoted by SKM is: “assets which are ‘not shared’ and are ‘dedicated’ to one customer...”</p> <p>How should ERC treat assets which are initially dedicated to one customer but have a high likelihood of being used by other customers? Will these assets be treated as Connection Assets and be removed from the CAPEX Forecast?</p>	<p>ERC should specify how it will treat assets that are initially being used by one customer but later on will become network assets.</p>

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3.17 (p. 32)	Projects that need further justification from TransCo	TRANSCO	<p>Generally, these expenditures cover capex proposals from the following:</p> <p>a) Capitalized O &amp; M expenses are proposal from the Operations and Maintenance Group of Luzon, Visayas and Mindanao presented in the table as TransCo 1 &amp; Concessionaire 1 (North), TransCo 2 &amp; Concessionaire 2 (South), TransCo 3 &amp; Concessionaire 3 (Visayas) and TransCo 4 &amp; Concessionaire 4 (Mindanao): projects include various rehabilitation, replacement work on existing transmission and substation facilities; e.g. upgrading of 230kV bus protection system, upgrading/replacement of circuit breakers, installation of CT/PT terminal block, and such other work that will improve the reliability and quality of service. The details of these proposals are provided under Attachment 6 – Details of Forecast Capital Expenditures for Operations &amp; Maintenance Group.</p> <p>b) Allocated Overheads – Administration: represents capitalized cost for support services to engineering projects. This covers capitalized portions of the expenses of the Head Office Support Groups allocated using an allocation rate based on the extent of support services rendered to operations and capital projects. These include costs of personal services (salary and benefits) and overhead expenses like traveling, training, anti-pilferage budgets &amp; meal allowances provided to military personnel which is basically for security purposes of on going projects, light and water of project offices and other related costs.</p> <p>c. Allocated Overheads – Site Management &amp; Projects: these cover capitalized overhead cost for the manpower supervision, inspections, monitoring of project implementation and construction. These are necessary activities in order to meet the project plan and specifications for the timely project completion and quality completed transmission lines and substations.</p> <p>d. Allocated Overheads – Engineering: these represents capitalized costs of manpower and overhead expenses of the Engineering Design Group and annexed offices. This group is responsible for the detailed design of Transmission lines, substations, control buildings, switchyards and other TransCo facilities. It also finalizes the tender documents/specifications of all TransCo projects for bidding. The cost/expenditures under Engineering are mostly capitalized since the nature of expense is directly related to infrastructure projects.</p> <p>e. System Operations Concessionaire &amp; TransCo (Luzon Visayas &amp; Mindanao): covers capital expenditures for the upgrade/expansion of integrated network management system, acquisition of monitoring/management system for auxiliary equipment, upgrading of microwave radio link from PDH for interconnection in Visayas &amp; Mindanao Grid and other system upgrade that will address timely determination and correction of system faults/troubles, efficient communication and system reliability. Details of proposed capital expenditures are provided in <b>Attachment 7.</b></p> <p>f. Provision for land use costs from pending litigation: These are the cost of ROW payments for expropriated properties affected by transmission lines and substation facilities which have been awaiting decision. Details are provided under <b>Attachment 8.</b></p>	

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			<p>g. Head Office: This covers the capital expenditures of the Head Office Support Groups of TransCo that extend support services to capital projects. This also covers acquisition equipment and spares for the following equipment helicopter, motor vehicles and proposals for LAN/WAN projects and other application system endeavors. Details are reported under <a href="#">Attachment 9</a>.</p> <p>Please note that TransCo, in capitalizing costs, follows the policy laid down in IAS 16 (PAS) Property, Plant and Equipment. IAS 16 is hereby provided as <a href="#">Attachment 10</a>.</p> <p>Also, please take note of the following corrections on Table 3.7:</p> <p>First item: "Allocated overheads – Interest During Construction" should read as "Allocated overheads – Admin"</p> <p>Second item: "Allocated overheads – Admin" should read as "Allocated overheads – Engineering"</p> <p>Third item: "Allocated overheads – Engineering" should read as "Allocated overheads – Interest During Construction"</p> <p>For reference we are attaching revised Table 3.7, as <a href="#">Attachment 11</a> (Corrected Table 3.7), for the Draft Determination that reflects the account title with the correct values.</p>	
Chapter 3.22 (Page 35)	Summary of Outcomes of Analysis for Draft Determination	MERALCO	The total cost of unapproved projects in Table 3.5 is only P 288.41 million. Please clarify if the cost of Unapproved projects in Table 3.10 includes proposed projects that have not been applied or approved by ERC, such as the San Jose-Balintawak Transmission Upgrade. In Item 3.22.1 (c), it seems only those projects in Table 3.5 will not be included in the CAPEX.	For clarification.
Sec. 3.22.1 and 3.22.2, page 35	Summary of Outcomes of Analysis for Draft Determination	FDC - Cebu	it is appreciated that ERC endeavoured to streamline CapEx and appropriately adjusted it for the applicable CPI and ForEx (see Table 3.10 as to the actual figures)	a stark difference is observed between the amount stated by TRANSCO for CapEx in its application and as determined by ERC; the amount determined by ERC seems to be understated
3.22.1.c	c. Remove unapproved capex projects described in Table 3.5	TRANSCO	Section 3.15.1 explicitly stated that capital projects contained in Table 3.5 <u>shall be allowed</u> since they are not covered by the provisions of the EPIRA requiring prior approval from the ERC. It appears that these projects were taken out from the proposed CAPEX forecast. In this regard may we be clarified if these projects were considered in the rolled-forward or were actually removed from the total forecast CAPEX proposals.	The reference to Table 3.5 appears to be a typographical error, please clarify.

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Section 3.22.1	Removal of : Table 3.5 Completed, On-going Projects without ERC approval Table 3.6 Connection Assets Table 3.7 O & M overhead  Use ERC CPI and Forex Forecast	TRANSCO	We emphasize that these projects support the peak demand as forecasted. The corporation has contractual commitments to settle all remaining claims for these on-going projects.  The reclassification of the remaining assets necessarily will result in changes in the OATS There is a corporate policy that all costs attributed to the completion of a project should be capitalized & considered as asset cost.  CPI and Forex assumptions should be consistently applied in the entire forecast	All projects implemented prior to the effectivity of RA 9136 should be considered as majority of the expenses are already incurred and only the remaining claims are included in the forecast. Consider impact of the change in the composition of connection assets in the OATS Refer to IAS No. 16 ( SFAS No. 6)
Section 3.22.2		NICAI	It is significant to note that Figure 3.4 shows a ballooning of expenditures in the year 2007 which tapers off downwards towards 2010. This indicates an inconsistency of expenditures vis demand growth. We may however attribute this trend in investments to TRANSCO's desire to correct deficiencies which can be violative of Grid Code provisions while also ensuring adherence to the N-1 criterion.  We still need to see how expenditures have been related to demand projections on a per region or province and not just grid projections – We expect the GMC to use this approach in recommending approval of projects under the TDP	
3.22.8	(Table 3.12 lists the capex projects to be included in the forecasts and analysis of the Draft Determination.)	TRANSCO	Generally, the following projects are excluded from the list: (1) completed and on-going projects that underwent without prior ERC approval; (2) projects that need further justification from TransCo; and (3) projects that are classified as 'connection assets' by ERC.  There appears, however, no reason why the following projects are excluded from the list: 1. Luzon-Mindoro Interconnection Project 2. San Jose 500 KV Reconfiguration (Luzon) 3. San Jose-Balintawak T/L Upgrade (Luzon)	
Appendix A	Capital Expenditure Forecast Breakdown	MERALCO	Projects Nos. 7 (Luzon Substation Expansion-1) and 9 (Luzon Substation Expansion-3) in Table A.3 were not in Table A.1. Project No. 8 (Luzon Cluster C Substation Expansion) in Table A.1 was not in Table A.3. Project No. 18 in Table A. 3 (New Naga S/S) was not in Table A.1.	For clarification
Appendix A	Capital Expenditure Forecast Breakdown	MERALCO	It is the opinion of Meralco that Biñan-Sucacat 230 kV line upgrade and Tap Hermosa-Balintawak projects should be classified as Capital Projects - Network Assets since said lines will be part of the main grid of Transco. The "Tap Hermosa-Balintawak project" is not exactly a tap but a cut-in to the existing Hermosa-Balintawak line which serves as a main line to delivery power from the north, specifically from the Limay power plant and before, as a main outlet of the mothballed Bataan Nuclear Power Plant (BNPP). There are still plans to re-power the BNPP. Likewise, the upgrading of the Biñan-Sucacat line is needed to deliver power from the power plants in the South, specifically the new 500 MW San Lorenzo, rehabilitated 425 MW MakBan and uprated 718 MW Kalayaan power plants.	For consideration

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Appendix A (Page 133)	Capital Expenditure Forecast Breakdown	MERALCO	Since the Dasmariñas-Rosario line project was classified as a connection asset project and will only benefit a specific customer, said project should be undertaken by the distribution franchise owner and not by Transco.	For consideration
Appendix A	Capital Expenditure Forecast Breakdown	MERALCO	What happens to projects of DUs that will cut-in to grid facilities in order to serve as new delivery points? It is recommended that Transco own and operate the cutting-in facilities to clearly delineate circuit responsibility as envisioned in the EPIRA. This was successfully implemented in the development of the Zapote Substation where Transco owned the 230 kV switchyard while Meralco owned the 115 kV switchyard. Thus, in the Meralco proposed development of Amadeo delivery point substation in 2008, Transco might have to include the cost of the 230 kV Amadeo switchyard in its CAPEX. The said substation will cut-in to the Calaca-Dasmariñas 230 kV lines which serves as major outlets for the 600 MW Calaca and 1000 MW Sta. Rita power plants. Meralco responsibility and ownership will start at the primary of the 300 MVA step-down transformer which clearly only serves the loads of Meralco.	For consideration
Chapter 4				
	Operating and Maintenance Expenditure Forecasts	NICAI	We agree to ERC's adjustments as drafted in as far as the approach is concerned but we suggest using the EIU projections for CPI and FOREX to form basis for projecting future OPEX. We likewise agree that major OPEX components like Salaries should be tied to performance measurements before any adjustments be made.	
Section 4.2.1	Level of OPEX is related to the Level of CAPEX	TRANSCO	Only to some degree. OPEX increases as more and more projects are completed and commissioned.  We suggest that the ERC consider the requirements of newly commissioned projects as they are put into operation in terms of manpower and maintenance and operating expenditures.	
Section 4.2.2	OPEX may be lower than required given the expected remaining life of the assets	TRANSCO	For as long as the asset is still operational and in use the level of OPEX should be the same, unless there will be full automation where the personnel requirements becomes less and less. On the contrary, the Maintenance Operating and Overhead Expenses (MOOE) increases as the assets age increase because they require more and more maintenance costs and time to maintain reliability.  The benchmarks presented should consider the degree of technology adopted by the other firms vs. the present state of TransCo.	
4.3, (Page 40)	Relationship to Reliability performance	CEPALCO	The last sentence of section 4.3.3 states that the Transco is in violation of the Grid Code, which requires that the transmission system should be characterized by N-1 security (cf. Sec. 7.2.2 of the Grid Code).	
Chapter 4.3.7 (Page 41)	Relationship to Reliability Performance	MERALCO	In Figure 4.1 (SAIDI and OPEX), in general, the SAIDI should be lower with higher OPEX and not the other way around.	For clarification

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Section 4.5.9	Payroll cost are increasing quickly and represent a large component of OPEX	TRANSCO	<p>TransCo adopts a manpower module for every project or facility newly commissioned, the personnel cost shows a steady increase as more projects are commissioned to address the increase in demand. In addition, TransCo also adopts a compensation program that allows its employees remuneration to be at par with others in the industry.</p> <p>Also, TransCo considers in its payroll forecast, government declarations of increases in salary and allowances.</p> <p>Please note that for the past three (3) years, TransCo has not given any salary increases to its employees. The upward movement in the salary as submitted attempts to make TransCo salary comparable to what others is receiving for the same job function, in related energy business.</p>	
4.5.13 Page 45	Transco clarifies that the discrepancy between the initial OPEX forecast and the revised OPEX forecast submission is principally due to the different FOREX rates and CPI assumptions used.	TRANSCO	<p>The clarification made by TransCo is the discrepancy between the OPEX Forecast presented in exposition hearings which is also the Modified Forecast Operating Expenditure in Table 9.8 of Annex A versus the one attached in Schedule 3 of Annex A of the Application. The discrepancies were due to the ff.:</p> <ul style="list-style-type: none"> <li>• Exchange Rates &amp; CPIs for Modified Forecast OPEX in Table 9.8 are based on Relative Purchase Power Parity and data from the Economist Intelligence Unit</li> <li>• The one provided in Schedule 3 under Annex A is based on macroeconomic assumptions from the Dev. Budget Coordination Committee (DBCC).</li> </ul> <p>However, in the draft determination ERC compared the initial OPEX forecast of Transco against the revised. The discrepancy are due to the following:</p> <ul style="list-style-type: none"> <li>• Exchange Rates &amp; CPIs used</li> <li>• Reduction in payroll cost as recommended by the consultant</li> <li>• Inclusion of Station Use under the Network Related.</li> <li>• Computation of Bad Debts (which is computed based on the resulting MAR in the revised projections).</li> </ul>	
4.5.17 Page. 47-48	High cost of Non-Network in terms of percentages	TRANSCO	<p>Reasons for the High Cost of Non-Network in terms of percentages are as follows:</p> <ul style="list-style-type: none"> <li>➤ Higher Forex and CPI assumptions used in the revised forecast as compared to the initial forecast. Revised opex forecast used the assumption in Table 4.5 page 46 while in the initial run it uses Table 4.2 page 42.</li> <li>➤ Bad debts contributed largely to the increase in Non-Network. In the Initial Opex Forecast Bad Debts was computed based on the outstanding balance of Power Receivables while in the revised forecast bad debts were based on the computed or resulting annual MAR over the 2<sup>nd</sup> Regulatory Period.</li> </ul> <p>Reasons for the moderate increase in the Network Cost are as follows:</p>	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
	Moderate increase in the Network Cost		<ul style="list-style-type: none"> <li>Higher Forex and CPI assumptions used in the revised forecast as compared to the initial forecast.</li> <li>Station Use of Transco installations. Note that for the past years, the National Power Corporation has been subsidizing Transco for the cost of power consumption of its substations/installations. However, NPC has already signified its intention (reference to the Cooperation Agreement between TransCo and NPC) to bill TransCo with the electricity consumptions of all its substations and other facilities. Attachment 10 is the copy of the Cooperation Agreement signed by TransCo and NPC.</li> </ul>	
Section 4.7.1 page 48	Transco's performance was compared with electricity transmission business in Australia and UK.	TRANSCO	The source of data on Table 4.9 under Section 4.7.1, page 48 came from Annex E, page 12 of Transco/PSALM Application as indicated in the footnote. We note that the figure for Transco Opex (local currency) amounting to P6,155 is not consistent with the figures indicated in Annex E, page 12 which amounted only to P3,703. TransCo requests clarification on this matter.	
Sec. 4.10.9, page 55	O & M Expenditure Forecasts (Outcomes Using the PPP)	FDC - Cebu	ERC suggests that OPEX be consistent to the growth of the asset base and the expected demand and energy growth of TRANSCO throughout the 2 <sup>nd</sup> Regulatory Period	a decrease in the level of OPEX would be expected and due consideration be observed on the CAPEX – OPEX trade-off; OPEX must be adequate to ensure reasonable efficiency relative to the system peak demand
4.10.9 Page 55	Decrease of OPEX cost to a level consistent with the growth of asset base and expected demand and energy growth.	TRANSCO	It may be appropriate with ERC's suggestion that the OPEX cost level be directly related to the growth in asset base and the expected demand, but only if the initial level is sufficient for current operations. That is not the case with TransCo's OPEX as salaries are below market rates. This situation cannot be sustained indefinitely. Payroll Cost should also consider salary rates comparable with those of employees of other energy companies in Asia and adjustment made to bring TransCo salaries in line with reasonable rates.	
4.12.1 Page 55	Bad Debts – Exclusion of bad debts from the OPEX forecast	TRANSCO	<p>We agree that bad debts provision does not contribute to the operating efficiency of Transco in collecting its receivables but we do not agree that it would give room for possible inefficiencies of Transco's collection procedures. Actually, Transco is forecasting a gradual reduction in the level of bad debts. This reflects the phased implementation of Transco's credit and collections policy made possible as inherited contracts are renewed. Under these policies, on contract renewal, customers will be required to meet a credit worthiness test and may be obliged to deposit a bond or bank guarantee.</p> <p>Nevertheless, bad debts cannot be eliminated although can be minimized through the said policy. Generally, any form of business should consider bad debts in their forecast of operating expenses because it is unrealistic not to have such.</p>	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
4.12.1 (Page 55)	Exclusion of Bad Debts from the OPEX forecast	CEPALCO	It may be noted that the TWRG recognized Bad Debts as part of the OPEX. (Pls refer to TWRG Section 4.11.1(i), page 49).	
Chapter 4.12.1 (Page 55)	<p>Bad Debts</p> <p>Bad debts should be excluded from the OPEX forecast because it does not contribute to operating efficiency of Transco in collecting its receivables and thus it would give room for possible inefficiencies in Transco's collection procedures which should not form part of the MAR.</p>	MERALCO	Bad Debt is an inevitable expense which must be included as part of OPEX. However, only a reasonable level of Bad Debt should be allowed in order to discourage possible inefficiency in the collection of receivables.	A reasonable level of Bad Debt should be allowed in the OPEX.
Section 4.12.2	As such the 'loss factor' the Commission allow TransCo to implement in this process allow it to partially recover the cost of both technical and administrative losses.	TRANSCO	<p>We do not see the relationship of the 'loss factors' or system loss that we incorporate in our billing system (grossing-up of billing determinants) with respect to recovery of bad debts. Unlike the distribution utilities that bills customers with specific tariffs on system loss, TransCo does not have specific rate for the recovery of these loss factors.</p> <p>Under the current performance base regulation (PBR) – revenue cap methodology and the ERC-approved OATS Rules, the incorporation of the loss factors in the billing determinants only affect the allocation of the power delivery service (PDS) among customer and not the amount received by TransCo. The grossing-up of the demand (kW) reading from the load side with the loss factors, effectively, reduces the PDS rates to the customer for each customer segment. The grossing-up with loss factors increases the demand (kW) reading to reflect the 'almost' values of the demand from the generator side.</p> <p>It would have been different if ERC is still regulating TransCo under a Return on Rate Base (RORB) methodology. It should be noted that under the RORB, ERC approves the TransCo's tariff or rate that are to be charged to customer for each type of service. Perhaps, under RORB, the ERC's statement that the grossing-up of the billing determinants with the loss factors allows TransCo to recover the cost of both technical and administrative losses could be true. As in the unbundling, TransCo increases the demand (kW) reading with the application of the ERC- approved loss factors to calculate for the billing determinants and these billing determinants are subsequently multiplied to the ERC-approved rates for the transmission delivery charges. In this manner TransCo will account for increase revenue compared to the calculation where the loss factors are not applied in the calculation of the billing determinants.</p>	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
			<p>Again, TransCo, with the present regulation, emphasizes that the grossing up of the demand with the loss factors does not in any way allow TransCo to recover bad debts. More so it does not increase our revenue since TransCo's revenue is capped.</p> <p>One should also note that in TransCo's expenses there exists no specific account title that record system losses as an expense. Had there been any, we would have included it in TransCo's OPEX and be part of the building blocks (OPEX) in the Annual Revenue Requirement (ARR).</p> <p>Notwithstanding the above, TransCo would still want to be clarified on how the loss factors compensate TransCo for bad debts.</p>	
4.12.2 (Page 55)	Discussion on why Bad Debts are excluded in the OPEX forecast	CEPALCO	We fully agree with ERC that a "cap" on technical line loss and administrative loss that TRANSCO can pass on to Grid Users shall be set. Further, we think that the existing "loss factor" being applied in the grossed-up billing of TRANSCO does not include provision for bad debts. Hence, the discussion that bad debts should be excluded since it is already addressed by the grossed-up billing of TRANSCO is not correct since such billing procedure only allows recovery of line loss.	
Section 4.13	ERC recommends that forex gain or loss should be excluded as part of OPEX forecast	TRANSCO	<p>TransCo adopts generally accepted accounting policies consistent with the government accounting manual.</p> <p>May we also note, that TransCo at this time does not record or project any forex gain or loss.</p>	
Section 4.14	ERC proposes that payroll should be restricted to increase at CPI rates	TRANSCO	<p>We see that payroll could be restricted to increase at the CPI rates only after salaries have been adjusted to the rates at par with other energy related business.</p> <p>Refer to TransCo's comments on Section 4.5.9.</p>	
4.14.1 page 56	The ERC also noted that when Transco revised its OPEX forecasts, it increased the Network Operations and Maintenance cost while reducing Payroll. Costs.	TRANSCO	<p>The reasons for the increase in Network Operation and Maintenance cost are due to the ff.:</p> <ul style="list-style-type: none"> <li>• Higher Forex and CPI assumptions used in the revised forecast as compared to the initial forecast.</li> <li>• Forecast energy/electricity consumptions of TransCo's substations and other offices. We see it fit to forecast this expense as Meralco, with respect to TransCo's substation in Balintawak, decided to bill us with its electricity consumptions.</li> </ul> <p>Also, NPC already intends (reference to the Cooperation Agreement between TransCo and NPC) to bill TransCo with the electricity consumptions of all its substations and other facilities.</p>	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
4.14.2 page 56	Number of options which ERC has considered fro its Draft Determination for Payroll.	TRANSCO	<p>The following options were considered by ERC for its Draft Determination:</p> <ul style="list-style-type: none"> <li>• Restrict the labor based expenses categories of Payroll to rise by a factor of CPI plus 15% from the 2005 level.</li> <li>• Overseas benchmark nearly “flat” against the circuit kilometer and other benchmark measures for Payroll</li> <li>• Restrict Payroll to rise CPI less 2% from the 2005 level</li> <li>• As stated in 4.18.1 (b) to allow the Transco OPEX Forecast to be escalated by the percentages depicted in Table 4.10 (Payroll has various percentages of escalation per year).</li> </ul> <p>In this regard, we request that TransCo be provided with the schedule showing computation on how ERC arrived at the Payroll Cost indicated in Figure 4.10 page 61 of the Draft Determination?</p>	
Chapter 4.14.4 (Page 57)	Payroll and Network Expenses	MERALCO	<p>For the Draft Determination, ERC restricted the Payroll Expense to rise at CPI less 2% from the 2005 level.</p> <p>How did ERC determine the “CPI less 2%” figure? A payroll increase lower than the inflation rate seems unreasonable.</p>	For clarification
Section 4.16	Removal of OPEX related to Sub-Transmission Assets (5% reduction)	TRANSCO	<p>TransCo OPEX covers network, connection/sub- transmission expenses. Sub-transmission expenses are very minimal and may not amount to 5%.</p> <p>Please note that up to this time, January 2006, contracts on the sale of TransCo’s sub-transmission assets have not been approved by the Commission. In this regard, we see that there is a need to recalculate the OPEX related sub-transmission assets to match the revised timetable of asset disposal. Sub-transmission assets original forecasted as disposal in 2005, amounting to P1,526 Mn (Table 5.8) should be re-aligned as disposal for 2006. It is but fitting to re-assess the timetable of forecast disposal.</p> <p>We request the Commission to provide us the accounting or record of the OPEX related to sub-transmission which was deducted from TransCo’s forecast OPEX.</p>	
4.14.2 (b) page 56	Starting with a 5% reduction in Network Operation and 25% reduction in Network Maintenance expenses for 2006	TRANSCO	Please clarify this option. What is the basis of the suggested percentage of reduction under Network Related particularly the 25%?	
4.14.2 (d) page 56	Restrict Payroll to rise at CPI less 2% from the 2005 level	TRANSCO	<p>Please clarify this option. What is the basis of ERC in restricting the Payroll to rise at CPI less 2% from the 2005 level? May we also know the basis and rationale for the 2%, 5% and 25% figures, respectively?</p> <p>Note that for CY 2006, Transco’s budget proposal submitted to DBM includes a 10% increase in salaries as previously announced by the Bureaucracy on its plan to increase salaries due to constant increases in fuel prices &amp; other related oil products and the implementation of E-VAT.</p>	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
4.16.4 page 59 (cont. . . )	Removal of OPEX related to the Sub-Transmission assets	TRANSCO	<p>We consider the move of ERC to reduce from OPEX (Network Operations Supervision &amp; Eng Staff, Network Operations Other Staff, Network Operations and Network Maintenance OPEX categories) forecast assumed to represent an estimate of the OPEX related to Transco's sub-transmission assets to be divested. However, please note that ERC has yet to approve a single conditional sale of sub-transmission assets and until such time when operation and maintenance of these assets shall be taken away from Transco, these shall remain responsibility of Transco.</p> <p>The Contract of Sale on sub-transmission assets provided that until the sale agreement is approved by ERC, maintenance of the said assets remain with Transco. In the event that O&amp;M shall eventually be transferred to the Buyer of these facilities, we agree that OPEX will be reduced, however, only up to the extent of the percentage portion of the subtransmission assets divested to the total assets of TransCo, following the principle that OPEX is largely related to Asset Base.</p>	
4.16.4 page 59	Uniform reduction of 5% from the proposed Transco forecast net of the OPEX related to connection assets, shall represent OPEX related to its sub-transmission assets.	TRANSCO	Please clarify this option. What is the basis of ERC on the 5% reduction representing the OPEX cost related to sub-transmission assets?	
Sec. 4.18.1, page 62	Summary of Outcomes of Analysis for Draft Determination (O & M Expenditure Forecasts)	FDC - Cebu	exclusion of bad debts and ForEx gain or loss is deemed appropriate ; escalation of TRANSCO's OPEX forecast as that enunciated in Table 4.10 and Fig. 4.10 for the 2 <sup>nd</sup> Regulatory Period shall instead be adjusted based on empirical data of OPEX drivers as advanced in Sec. 4.15.2 (pp 57 – 58)	with payroll being the more dominant expense over network and non-network related costs, enhanced and improved productivity and performance from personnel and human resource shall be expected; improved reliability performance measured through better operational efficiency
4.18 page 62	Summary of Outcomes of Analysis for Draft Determination.	TRANSCO	We request that TransCo be provided with the worksheets showing the adjustments made to each expense category used by ERC in its analysis. These shall be used in Transco's study and evaluation on ERC's adjustments.	
4.18.1 (a) page 62	Excludes Foreign Exchange Gain or Loss From the Operational Expenditures	TRANSCO	The OPEX forecast submitted to ERC under the Non-Network Related Category provides no proposal for Net Foreign Exchange Gain or Loss.	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
4.18.1 (Page 62)	Summary of Outcomes of Analysis for Draft Determination	CEPALCO	<p><b>1. On Item (a) Exclusion of Bad Debts and FOREX gain or loss from the OPEX forecast:</b></p> <p>We agree on the exclusion of FOREX gain or loss from the OPEX forecasts since the CWI adjustment and the trigger process already take care of this. However, consistent with our comment on Section 4.12.1, we disagree on the exclusion of bad debts in the OPEX forecast. The ERC should allow a reasonable level of bad debts, to be set based on historical trend, with abnormal levels taken-out, as part of the OPEX forecast. This is consistent with the TWRG which recognized bad debts as part of the OPEX forecast. (TWRG Section 4.11.1(i))</p> <p><b>2. On Item(b): OPEX Forecast Escalation based on the Percentages set by ERC</b></p> <p>The ERC adopted a “CPI less 2%” in the evaluation of TRANSCO’s OPEX forecast. We think that this approach is a double application of the X-factor in the “CPI-X” supposed to be carried out in the pricing formula for MAR. Applying it in the OPEX forecast may mean double imposition of the efficiency factor.</p> <p>Also, there seems to be arbitrary restrictions/reductions of the OPEX forecasts, e.g., 25% reduction in the Network Maintenance Expenses, 95% restriction of the 2005 TRANSCO/PSALM forecast, etc., (Pls refer to Section 4.14.4). We believe these arbitrary restrictions are not provided for in the TWRG.</p> <p>Further, the determination of the forecast OPEX levels by applying “CPI-2%” and the arbitrary restrictions/reductions on the forecasted OPEX may not be able to consider the possible increase in OPEX in order to meet the targeted performance levels.</p> <ul style="list-style-type: none"> <li>Consistent with Section 4.16 (Page 58), exclude also in the OPEX forecast, the OPEX corresponding to the CAPEX, aside from sub-transmission and connection assets, that will be disallowed by the ERC in the course of their evaluation.</li> </ul>	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Chapter 5				
	Regulatory Asset Base and Valuation	LAPOCOF	<p>The registers for the Regulatory Asset Base, in order to by truly a representation of the Transmission Wheeling tariff should be free of other assets that comprise sub-transmission and connection assets. The periods between the Draft Determination and the Final Determination should complete the exercise of making the RAB free all these mentioned other assets.</p> <p>From the hearings, it was known that network equipment in the RAB was revalued using the Modern Equivalent Asst Analysis approach whereas the other assets comprising land, buildings, office equipment and those not used in the network were revalued by indexation and/or by replacement cost analysis.</p> <p>We interpret in the TWRG that the MEA approach is used when replacement cost is not obtainable or in a situation where the asset is no longer manufacture (p32 of TWRG).</p> <p>LAPOCOF is very much concerned that the major portion of the TRANSCO RAB having been revalued using the MEA approach would tend to bloat the value of the RAB. Moreover, a modern equivalent asset doesn't always mean cheaper asset for the same utility and purpose (like in the case of computers and cellular phones). In fact, the RAB when revalued by the MEA is not yet in the field--- we are very hopeful that the optimization exercise would somehow temper and correct the tendencies of a bloated RAB by the MEA valuation.</p>	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
		NICAI	<p>The Rolled-forward Asset Base as determined by the ERC excludes projects implemented without ERC approval. This might result in a re-opening of the rate case if the amounts excluded are substantial. We suggest a speedy evaluation of such projects to be in time for final determination of rates.</p> <p>Also the classification of assets into Network and Connection classes hinges on ERC's prior approval of the policy for such. Without these guidelines, the corresponding breakdowns in the draft determination become baseless.</p>	
5.2.13 (p 63)	Adjustment (for windfall gains) warranted	TRANSCO	<p>The Draft Determination states that it would probably benefit economic efficiency for TransCo not to recover any windfall gain and for TransCo not to be subject to any windfall loss. The Draft Determination also suggests that demand side management price signals would be improved by removing windfall gains and losses. Both of these statements are wrong in theory and in terms of the principles that underpin the building block approach to price setting in the TWRG.</p> <p>The objective of price regulation based on the building block model with valuation of assets at ODRC is to mimic the market conditions that an efficient new entrant would face under conditions of reasonable competition. In such a market, the prices determined at each reset should reflect the cost and demand conditions expected to apply through to the next reset date. If prices reflect a higher than expected level of costs then a new entrant would take away the business of the existing firms operating in the market. Conversely, if prices reflect a lower level of costs then the new entrant could not expect to get any business. In such market conditions, prices will reflect opportunity cost and thus provide optimal signals for resource allocation, including demand side management.</p> <p>During the period to the next reset, firms may earn a rate of return on capital that is significantly higher or lower than the rate that was used in setting prices for the period. This can arise because of unexpected deviations of costs and/or demand from expected costs and/or demand. One possible source of cost variance is longer or shorter than expected asset lives. If examination of the assets at the reset date reveals the assets to have longer than anticipated remaining lives then depreciation would have been overstated during the recent period. Thus, with the benefit of hindsight, it would be recognized that prices were set at a higher level than required to provide for return of capital and a lower level than required to provide for return on capital. In such cases, the net effect is that prices would have been set higher than warranted had the lower rate of decline in service potential of the assets been correctly anticipated. That is, the entity would recognize a windfall gain. Conversely, if it were discovered that asset lives had been overestimated then the entity would recognize a windfall loss. Such windfall gains or losses should be regarded as being non-adjustable in respect of price determination for the next period. If, in the event of there having been a windfall gain, existing firms were to factor that gain into prices for the coming period, price would be below the competitive level and therefore a new entrant could not compete with the existing firms. Conversely, if there had been windfall losses then prices set at a level intended to compensate existing firms for the losses would be above the competitive level, and thus the existing firms could not compete with new entrants.</p>	Adjustment for windfall gains and losses is not warranted in theory or in terms of the principles of the TWRG, and the proposed adjustments should be removed.

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
			<p>In principle, attempts to adjust for such windfall gains (losses) could be expected to compensate consumers (firms) for forecasting errors in the previous period. However, the system would then operate with distorted price signals for resource allocation, including distorting price signals for demand management. Furthermore, in practice, errors in forecasting for the coming periods might have naturally provided compensation anyway for the forecasting errors of the previous periods. Indeed, that is exactly what should be expected. If the forecasts of costs and demand are unbiased then windfall gains and losses could be expected to balance out and do so over reasonably short sequences of resets, thus avoiding any serious cause for concern for intergenerational equity. If that proved not to be the case, then (rather than deliberately distort price signals) the Regulator should question the effectiveness of the monitoring of the forecasts used in the system of price determination.</p>	
5.2.16 -5.2.17 (p 67-68)	Calculation of any windfall gains or losses	TRANSCO	<p>In paragraphs 5.2.16 to 5.2.20, the ERC describes its approach to estimating the value of the windfall gains arising from changes to asset lives. The ERC concludes that a total of approximately PhP 11 billion should be excluded from the opening RAB. As noted above, the conclusion by the ERC that windfall gains should be removed from the RAB conflicts with the principles underpinning building block valuations. The Applicants submit that there should be no attempt to remove windfall gains from the RAB.</p> <p>The Applicants also submit that the basis on which the ERC has determined these windfall gains is incorrect. The prices paid by consumers in the period 1996 to 2005 were not set on a building block approach. Rather, the prices were set using the old system of regulation (RORB) with a lower (than WACC) allowed return on “unrevalued” assets. Hence, any “windfall” gains should be measured against what the prices would have been had the assets been valued appropriately and the return set at much higher levels - at that time, Meralco was allowed around 15% RORB while transco was allowed only 8% and on unrevalued assets.</p> <p>The Applicants do not expect to recover in the Second Regulatory Period these losses from the old system of regulation. However, it would be unfair and unreasonable to penalize TransCo for supposed windfall gains (in the past period) that were not obtained (because prices were not set on a building block approach) and not to allow TransCo to recover losses from the same period.</p>	
5.2.20	Depreciation and Windfall gain/ (loss) Treatments	LAPOCOF	<p>We believe and support ERC’s findings as contained in the their Draft Determination to exclude from the RAB, the P11Billion windfall gains.</p>	<p>We strongly endorse and suggest to ERC to firmly and finally subtract the P11 Billion from the opening RAB of the second regulatory period.</p>
5.2.20, (Page 68)  5.7.1 (a), (Page 75)	Windfall gains and losses in re-analysis of the ODRC valuation	CEPALCO	<p>Exclusion from RAB the windfall gains and losses in re-analysis of the ODRC valuation</p> <p>ERC included the windfall gain and loss estimates on those primary asset groups as identified</p>	<p>ERC should include in the RAB any windfall gains/losses so that the RAB reflects the true ODRC of all the assets at each valuation date.</p>

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Sec. 5.2.22, page 68	RAB & Valuation (Sound Value Assets)	FDC - Cebu	actual economic life of the various asset categories shall be purported to as appraised using sound value or market value techniques	systematic asset requirements which need periodic replacements— ORDC; essential assets used in the normal course of the business of TRANSCO, calculated based on their optimized composite economic life—Modern Equivalent Asset (MEA)
5.3.3	Remove connection assets from RAB	TRANSCO	The Draft Determination proposes that all of the connection assets that can be clearly identified be removed from the RAB for the purposes of developing the revenue cap from January 1, 2006. The Applicants agree in concept, provided relevant changes made to the OATS and Connection Policy to protect TransCo's revenue base relating to the connection assets. The Applicants intend to submit further comments on how the TWRG, OATS, and Connection Policy should be aligned.	
Section 5.3	Connection Assets	TRANSCO	Refer to SKM Report Volume A, Appendices J to N and Volume B  We request records or list identifying all assets that were classified as connection assets and were removed from the Regulated Asset Base.	
5.3.3	Connection Assets	LAPOCOF		We firmly endorse ERC's Draft to remove all connection assets from the development of revenue cap from the very start of the second regulatory period.
5.3.4	Sub-transmission Assets	LAPOCOF	We are appealing to ERC to be vigilant on TransCo's disposal of their Sub-transmission Assets that it will be conducted on the Fairest, Transparent Economical and Advantageous manner to the government and the consuming Filipinos.	
Sec. 5.3.4 page 69 (vis-à-vis 3.16.1 and 3.16.2, page 31)	Connection Assets (RAB & Valuation)	FDC - Cebu	assessment must be conducted on how TRANSCO classified projects as network or connection assets that must be consistent with the TWRG, the Connection Policy (as finally approved) and the determinant factors in the revenue reset for the 2 <sup>nd</sup> Regulatory Period	a non-discriminatory evaluation of reported connection assets as well as sub-transmission assets by TRANSCO and determine the identified assets which must be eliminated in the roll-forward of the RAB

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Section 5.4	Sub-Transmission Assets	TRANSCO	Refer to SKM Report Volume A, Appendices J to N and Volume B  We request records or the list that identifies substation assets that shall be considered in the RAB	Identify substation assets that shall be considered in the RAB
5.4.2 (Page 69)	Sub-transmission Assets	CEPALCO		<ol style="list-style-type: none"> <li>1. Subtransmission assets of Transco are not part of its transmission facilities. Hence, should be <b>EXCLUDED</b> entirely from the Regulatory Asset Base for transmission.</li> <li>2. Inclusion of sub-transmission assets in the RAB will make transmission customers subsidize the few users of the particular sub-transmission assets.</li> <li>3. Similarly the OPEX components that are for the operation and maintenance of subtransmission assets should be deleted from the OPEX submitted by the Transco.</li> <li>4. There should be a separate sub-trans charges to customers jointly using these facilities similar to Connection Charge.</li> </ol>
Section 5.4 Page 69	Sub-Transmission Assets	NASECORE	Sub-Transmission assets, whether for connection or not connection assets, should be excluded in the asset base of Transco as this will lead to double recovery by the applicant. The EPIRA expressly provides that these assets be sold to DUs, hence, Transco will be able to recover its costs from the sale for the DUs.	
5.5.2 (p 70)	ERC approach to treatment of windfall gains	TRANSCO	As noted above, the Applicant's believe it would be wrong in theory and inconsistent with the principles of the TWRG to adjust for windfall gains and losses as proposed by the ERC.	
5.6.4 (p 71)	ERC needs clarification on whether there is an overlap between civil works and establishment for substations etc	TRANSCO	For civil works and establishment we refer the Commission to the SKM's report on the matter. Pertinent discussions are provided in SKM's Report Volume A Section 9 and <b>Appendix D – MEA</b> Paper Section 5.7.1. These excerpts are attached as <b>Attachment 13</b> .  For Revenue Meters, pertinent discussions are provided under Volume A Section 11 of the SKM's Report. These excerpts are attached as <b>Attachment 14</b> .	
5.6.4	TransCo/PSAL M's Approach	LAPOCOF	That ERC will thoroughly and carefully review and require TRANSCO to submit a more detailed supporting documents on the appraisal valuation, in particular the Building, Civil Works and Establishment of Sub-stations and Meters to avoid an overlap and double counting of Asset and inflate the value of the Asset Base	

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
5.6.8 (p 73)	Adjustment for missing and double counted assets amounting to PhP 1,618.1 M	TRANSCO	<p>The ERC has sought further information regarding the adjustment proposed by the Applicants for missing and double counted assets, and a reversal of an initial optimization. In reviewing the final valuation report, TransCo identified some assets that were missing from the valuation, one instance of double counting, and an initial optimization that had inadvertently not been reversed. These discrepancies were discussed between SKM and TransCo, but were not identified in time to make adjustments to the final valuation report – see letter and attachments from Mr Michael Farr, Executive Consultant to SKM, to Ms Alva L Marasigan, Assistant Vice President, Finance dated 25 August 2005, included as <b>Attachment 15</b>.</p> <p>The assets are as follows:</p> <ol style="list-style-type: none"> <li>1. P2,027Mn inadvertent optimization of the Naga-Tayabas line.</li> <li>2. P912Mn for repeater stations that existing assets as 31 Dec. 2004 but were not included in the SKM report.</li> <li>3. P1,427Mn double counting of Interconnector land</li> <li>4. P6.7Mn PABX in Mindanao that are existing assets as 31 December but were omitted in the revaluation report</li> <li>5. P105Mn sub-transmission lines forecast for sale (and hence included in the disposals)</li> </ol> <p><b>Attachment 16</b> provides details of these assets, and cross-references the relevant spreadsheets in the SKM valuation report to show that the assets are missing or double counted, as the case may be.</p> <p>The Applicants submit that it would be unreasonable to penalize TransCo by omitting from the RAB assets that were mistakenly left out of the valuation by the Independent Expert (because of time pressures), and similarly, it would be unreasonable to proceed with a RAB in which double counting had been identified by TransCo. The Applicants submit that the Initial Re-valuation December 2004 RAB value of PhP 133,656 M should be increased by a net PhP 1,618 M..</p>	December 2004 RAB should be increased by PhP 1,618.1 M
5.6.9		LAPOCOF		To corroborate with ERC’s findings on how TransCo derived their end 2004 RAB of P133,650 Billion and surprisingly appeared table 5.5 became P144,793 Billion, we suggest to ERC to require TransCo to justify and submit relevant supporting documents /evidence.

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)																		
5.6.9 (P 73)	ERC needs clarification on why the December 2004 RAB at PhP 1333,656 billion becomes PhP 144,793 billion	TRANSCO	<p><b>Attachment 17</b> contains a letter from the Independent Expert explaining the indexation of assets to reflect changes in price levels between December 2004 and December 2005.</p> <p><b>Attachment 18</b> contains the roll-forward (indexation) calculations carried out by the Independent Expert, along with supporting worksheets. Since the initial submission, the Independent Expert has revised several calculations. This revision applied the indexation at the end of 2005 when the values have already accounted for new capex and disposals, rather than at the beginning of the year. This change is explained in a letter from Mr Rodelio Acosta of Isla Lipana &amp; Co to Mr Michael Farr, Project Manager, SKM dated November 3, 2005 and attached as <b>Attachment 19</b>.</p> <table border="1" data-bbox="684 565 1373 781"> <thead> <tr> <th></th> <th>Submitted PhP M</th> <th>Updated (November 2005) PhP M</th> </tr> </thead> <tbody> <tr> <td>RAB 2004</td> <td>133,656</td> <td>133,656</td> </tr> <tr> <td>Index to 12/31/05</td> <td>11,138</td> <td>10,865</td> </tr> <tr> <td>Adjusted RAB</td> <td>144,793</td> <td>144,521</td> </tr> <tr> <td>Missing Assets</td> <td>1,618</td> <td>1,618</td> </tr> <tr> <td>Modified 12/31/05</td> <td>146,411</td> <td>146,139</td> </tr> </tbody> </table>		Submitted PhP M	Updated (November 2005) PhP M	RAB 2004	133,656	133,656	Index to 12/31/05	11,138	10,865	Adjusted RAB	144,793	144,521	Missing Assets	1,618	1,618	Modified 12/31/05	146,411	146,139	The December 2005 RAB should be set at PhP 146,139 M, allowing for indexation and missing assets, but before WACC and CWIP adjustments (see following comments).
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5.6.10, 5.6.10 (p 74)	WACC adjustment to CWIP factor	TRANSCO	<p>In its Application, the Applicants claimed an adjustment to the December 2005 RAB of PhP 5,934 M. This adjustment was termed 'WACC adjustment to CWIP Factor', and is shown in Table 5.6 on page 74 of the Draft Determination. The ERC has sought further justification for this adjustment.</p> <p>The TWRG recognizes the time value of money to compensate for the time lag between the start of the construction period through to the commissioning date – see section 4.6.9 of the TWRG. The TWRG recognizes this time value of money by applying a "CWIP Factor" to the asset valuations.</p> <p>This CWIP Factor is applied to construction work in progress. (see section 4.6.10(b) of the TWRG). The CWIP Factor is also applied to the Initial Re-valuation – see section 4.6.10(a) of the TWRG. If the Initial Re-valuation were not indexed in this way, the valuation would significantly understate the cost of the assets as it would ignore the reality of the time taken to construct the assets that form the transmission network.</p> <p>The TWRG provides guidelines for calculating the CWIP Factor. Under section 4.6.9 of the TWRG, the CWIP Factor shall be calculated using a typical spend profile for the assets of the relevant type at the regulatory WACC over the typical construction period. The CWIP Factors used by the Applicants were determined by the Independent Valuation Expert. The method used by the Expert in calculating the CWIP Factor are set out in Appendix I 'Determining the Construction Work in Progress Factor'. This appendix I is attached as <b>Attachment 17</b>.</p>																			

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			<p>Section 4.6.9 of the TWRG include a requirement that the CWIP Factor is to use “the weighted average cost of capital determined by the ERC in accordance with Section 4.9 of the TWRG.” The ERC has not yet determined the WACC that will apply for the Second Regulatory Period.</p> <p>In preparing the rolled-forward RAB to December 2005 discussed above, the Independent Expert used a WACC value of 14.6%. In its Draft Determination, the ERC has proposed using a WACC of 15.44%. The Independent Expert on WACC engaged by the Applicants has recommended a WACC of 20%, including the additional risk premium, and 18% if the additional risk premium is excluded.</p> <p>The rolled-forward December 2005 RAB will need to be recalculated once the ERC has finalized TransCo's WACC. To assist the Commission to undertake sensitivity analysis, the TransCo MAR model contains scaling factors to adjust the December 2004 RAB valuation and 2005 capex for different WACC values. The scaling factors were determined using the Independent Expert's CWIP Factor spreadsheet models to re-calculate the December 2005 RAB valuation and the 2005 forecast capex for a range of possible WACC values. This information has been updated to re-calculate the roll-forward December 2005 RAB and 2005 Capex using the Commission's proposed WACC of 15.44%, and for the revised WACC values recommended by the Independent Expert.</p> <p>The table below shows the results as submitted in the Application using a WACC of 22%:</p> <table border="1" data-bbox="684 873 1608 1122"> <thead> <tr> <th>(All figures in PhP Mn)</th> <th>Unadjusted amount</th> <th>Scale Factor</th> <th>Resulting Adjustment</th> </tr> </thead> <tbody> <tr> <td>Opening RAB</td> <td>146,411</td> <td>3.902%</td> <td>5,713</td> </tr> <tr> <td>Depreciation on opening RAB</td> <td>(4,810)</td> <td>3.902%</td> <td>(188)</td> </tr> <tr> <td>Capex</td> <td>5,459</td> <td>7.59%</td> <td>414</td> </tr> <tr> <td>Depreciation on Capex</td> <td>(66)</td> <td>7.59%</td> <td>(5)</td> </tr> <tr> <td><b>Net adjustment at a WACC of 22.0%</b></td> <td></td> <td></td> <td><b>5,934</b></td> </tr> </tbody> </table> <p>The following table shows the adjustment to December 2005 RAB required at a WACC of 20%</p> <table border="1" data-bbox="684 1227 1608 1435"> <thead> <tr> <th>(All figures in PhP Mn)</th> <th>Unadjusted amount</th> <th>Scale Factor</th> <th>Resulting Adjustment</th> </tr> </thead> <tbody> <tr> <td>Opening RAB</td> <td>146,411</td> <td>2.87%</td> <td>4,202</td> </tr> <tr> <td>Depreciation on opening RAB</td> <td>(4,810)</td> <td>2.87%</td> <td>(138)</td> </tr> <tr> <td>Capex</td> <td>5,459</td> <td>5.50%</td> <td>300</td> </tr> <tr> <td>Depreciation on Capex</td> <td>(66)</td> <td>5.50%</td> <td>(4)</td> </tr> </tbody> </table>	(All figures in PhP Mn)	Unadjusted amount	Scale Factor	Resulting Adjustment	Opening RAB	146,411	3.902%	5,713	Depreciation on opening RAB	(4,810)	3.902%	(188)	Capex	5,459	7.59%	414	Depreciation on Capex	(66)	7.59%	(5)	<b>Net adjustment at a WACC of 22.0%</b>			<b>5,934</b>	(All figures in PhP Mn)	Unadjusted amount	Scale Factor	Resulting Adjustment	Opening RAB	146,411	2.87%	4,202	Depreciation on opening RAB	(4,810)	2.87%	(138)	Capex	5,459	5.50%	300	Depreciation on Capex	(66)	5.50%	(4)	
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			<p><b>Net adjustment at a WACC of 20%</b> <span style="float: right;"><b>4,361</b></span></p> <hr/> <p>The following table shows the adjustment to December 2005 RAB required at a WACC of 18%:</p> <table border="1" data-bbox="684 347 1614 558"> <thead> <tr> <th>(All figures in PhP Mn)</th> <th>Unadjusted amount</th> <th>Scale Factor</th> <th>Resulting Adjustment</th> </tr> </thead> <tbody> <tr> <td>Opening RAB</td> <td>146,411</td> <td>1.76%</td> <td>2,577</td> </tr> <tr> <td>Depreciation on opening RAB</td> <td>(4,810)</td> <td>1.76%</td> <td>(85)</td> </tr> <tr> <td>Capex</td> <td>5,459</td> <td>3.44%</td> <td>188</td> </tr> <tr> <td>Depreciation on Capex</td> <td>(66)</td> <td>3.44%</td> <td>(2)</td> </tr> </tbody> </table> <hr/> <p><b>Net adjustment at a WACC of 18%</b> <span style="float: right;"><b>2,678</b></span></p> <hr/> <p>The following table shows the adjustment to December 2005 RAB required at a WACC of 15.44%:</p> <table border="1" data-bbox="684 677 1614 888"> <thead> <tr> <th>(All figures in PhP Mn)</th> <th>Unadjusted amount</th> <th>Scale Factor</th> <th>Resulting Adjustment</th> </tr> </thead> <tbody> <tr> <td>Opening RAB</td> <td>146,411</td> <td>0.4388%</td> <td>642</td> </tr> <tr> <td>Depreciation on opening RAB</td> <td>(4,810)</td> <td>0.4388%</td> <td>(21)</td> </tr> <tr> <td>Capex</td> <td>5,459</td> <td>0.8400%</td> <td>46</td> </tr> <tr> <td>Depreciation on Capex</td> <td>(66)</td> <td>0.8400%</td> <td>(1)</td> </tr> </tbody> </table> <hr/> <p><b>Net adjustment at a WACC of 15.44%</b> <span style="float: right;"><b>667</b></span></p>	(All figures in PhP Mn)	Unadjusted amount	Scale Factor	Resulting Adjustment	Opening RAB	146,411	1.76%	2,577	Depreciation on opening RAB	(4,810)	1.76%	(85)	Capex	5,459	3.44%	188	Depreciation on Capex	(66)	3.44%	(2)	(All figures in PhP Mn)	Unadjusted amount	Scale Factor	Resulting Adjustment	Opening RAB	146,411	0.4388%	642	Depreciation on opening RAB	(4,810)	0.4388%	(21)	Capex	5,459	0.8400%	46	Depreciation on Capex	(66)	0.8400%	(1)	
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5.6.10, 5.6.10 (p 74)	Adjustment for CWIP at Dec 04, not commissioned in 2005	TRANSCO	<p>In its Application, the Applicants claimed an adjustment to the December 2005 RAB of PhP 8,054 M. This adjustment was termed ‘CWIP at December 2004, not Commissioned in 2005’, and is shown in Table 5.6 on page 74 of the Draft Determination. The ERC has sought further justification for this adjustment.</p> <p>As noted above in comments on section 5.6.9, the TWRG provides for a CWIP factor to be applied to capital expenditure in rolling forward the December 2004 RAB to December 2005 to compensate for holding costs of construction work in progress (clause 4.6.10(a) and 4.6.10(b) of the TWRG). Section 4.6.10(b) of the TWRG provides that the capex added to the Initial Re-valuation to be determined as</p> <p>“the actual of budgeted capital expenditure of the Regulated Entity on assets ... for the period from the date of the Initial Re-valuation to the date of commencement of the Second Regulatory Period to the extent that such expenditure is reasonable and to the extent it is attributable to assets which would (if they had been in existence as at the date of the Initial Re-valuation) be included in the regulatory asset base (as defined in Section 4.6.8), increased by the application of the relevant CWIP Factor ...”</p>	The Commission should add to the RAB work in construction during year 2005 which is not commission during year 2005. These assets are mistakenly excluded from the RAB and amount to PhP 8,054 M																																								

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)																									
			<p>Section 4.6.8(b) says that the regulatory asset base must only include assets to the extent that such assets “are in service”.</p> <p>In undertaking the Initial Re-valuation, the Independent Expert interpreted these provisions as allowing only the cost of work in construction as at December 2004 that is expected to be commissioned in 2005 to be added to the RAB. In Appendix I, page 13, the Expert states:</p> <p>“When construction of an asset is finished in the Year 2005, the new asset is included in the roll-forward analysis to arrive at the 31 December 2005 RAB.”</p> <p>Hence, assets that were under construction during Year 2005, but are not commissioned in Year 2005, are excluded from the asset base. This would be appropriate if the same valuation method was maintained in subsequent periods. That is the value of the asset would be added to the RAB, inflated by a CWIP Factor, when the asset was commissioned.</p> <p>However, the TWRG adopts a different method in rolling forward the RAB from 2006 to 2010. During this period, capital expenditure is added to the RAB in the year in which the expenditure is committed and no CWIP Factor is applied (because the capex added to the RAB earns WACC).</p> <p>Either method is a valid approach for incorporating capex into the RAB and will result in approximately the same returns to TransCo. The difficulty arises in switching from one method to the other. As a result of the switch, the value of work in progress during the year 2005, that is not expected to be commissioned by December 2005, is ignored and lost from the valuation base. This cannot be an intended result, and arises through either an oversight in the drafting of the TWRG or its interpretation by the Independent Expert.</p> <p>The following table shows the value of the construction work in progress inadvertently excluded from the RAB. For ease of reference, the table includes the cell references to the SKM valuation spreadsheet “Appendix B&amp;D – Capex Program.xls”.</p> <p><b>Subtotals from Appendix B &amp; D – Capex Program.xls, Worksheet:Summary</b></p> <table border="1" data-bbox="684 1081 1623 1448"> <thead> <tr> <th></th> <th>Forecast capex costs (includes EPCM of 15%)</th> <th>CWIP</th> <th>Forecast capex with CWIP</th> <th>Included in Dec 05 roll-forward calc</th> </tr> </thead> <tbody> <tr> <td>Total projects completed in 2005 Cell reference</td> <td>4,699 DB229</td> <td>759</td> <td>5,459 DJ229</td> <td>5,459</td> </tr> <tr> <td>Total projected completed post 2005 Cell reference</td> <td>6,633 DB893</td> <td>1,221</td> <td>7,855 DJ893</td> <td></td> </tr> <tr> <td>Total new projects in 2005</td> <td>249 DB915</td> <td>47</td> <td>296 DJ915</td> <td></td> </tr> <tr> <td>Total Cell reference</td> <td>11,581 DB918</td> <td>2,028</td> <td>13,609 DJ918</td> <td></td> </tr> </tbody> </table>		Forecast capex costs (includes EPCM of 15%)	CWIP	Forecast capex with CWIP	Included in Dec 05 roll-forward calc	Total projects completed in 2005 Cell reference	4,699 DB229	759	5,459 DJ229	5,459	Total projected completed post 2005 Cell reference	6,633 DB893	1,221	7,855 DJ893		Total new projects in 2005	249 DB915	47	296 DJ915		Total Cell reference	11,581 DB918	2,028	13,609 DJ918		
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			Hence the total value of work in construction excluded, incorrectly, from the RAB amounts to PhP 13,609 M – PhP 5,459 = PhP 8,151. At the time the Application was being prepared, the roll-forward calculations had not been finalized and the Applicants sought a conservative adjustment of PhP 8,054 M. Details of the CWIP is provided under <a href="#">Attachment 19</a> .	
Chapter 5.6.11 (Page 75)	Tables 5.7 (Roll forward for 2006 to 2010)	MERALCO	There are discrepancies between the CAPEX cost here in this table and the cost in Table 3.10. In 2006, Transco CAPEX in Table 3.10 is P 11,922.9 M while in Table 5.7, it is P 11,827.2 M.	For clarification
Section 5.7 Page 75	Options for Treatment of RAB	NASECORE	<p>Any appraisal increase of Transco assets should not be included in the computation of transmission rates as there is no actual money invested by Transco for rate setting purposes. Appraisal increase is a “ghost capital” of a utility resulting from upward valuations of old fixed assets.</p> <p>The Supreme Court in the case of RCPI vs. NWC et al. (G.R. 93044 dated 26 March 1992) declared: “[T]he retained earnings arising from appraisal increment do not represent hard cash but merely theoretical increases resulting from upward valuations of old fixed assets. There is no income or profit from the sale of goods or services. No income is realized from the reappraisal of fixed assets until such time as the machinery, equipment, and other fixed assets are sold or disposed of in the event of a liquidation of assets.”</p> <p>Disallowing Transco from including appraisal increases in its computation of its rates is in accordance with the ruling of this Commission in ERC Order dated 30 May 2003 (ERC Case Nos. 2001-646 and 2001-900), thus: “In calculating a utility’s weighted average cost of capital to be used in the determination of revenue requirements, the capital structure should reflect the actual sources of capital used to fund rate base. This synchronization of capital structure and rate base is necessary to assure proper recovery of capital costs. A mismatch between the components of the capital structure and the actual sources of funding for the rate base will result either in an over or under recovery of capital costs.” (Underlining supplied)</p>	
Chapter 5.8.1 (Page 76)	Table 5.8 (ERC’s Estimate of the Rolled Forward RAB for 2006 to 2010)	MERALCO	There are discrepancies between the CAPEX cost here in this table and the cost in Table 3.10. In 2006, adjusted CAPEX in Table 3.10 is P 3,073.7 M while in Table 5.8, it is P 2,999 M.	For clarification
5.8.3	ERC’s Estimate of the Rolled-Forward RAB for 2006 to 2010	LAPOCOF	We strongly support and endorse ERC’s reduction of CAPEX in the roll-forward for 2005. Further, we firmly suggest for the final exclusion of the total amount of both completed and ongoing CAPEX projects which TransCo has not submitted to the ERC as required by the EPIRA, as stated in Rule 6, Section 10(c), “Any plan for expansion or improvement of transmission facilities shall be approved by the ERC...” To teach TransCo a lesson and avoid the occurrence of this lapses in procedure.4	
Sec. 5.8.6, page 77	Summary of Outcomes of	FDC - Cebu	post valuation adjustments should take into account the WACC adjustments to the CWIP factor; recomputation be made on the initial roll-forward 2005 RAB as that	modification of the computed RAB for each year of the 2 <sup>nd</sup>

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
	Analysis for Draft Determination (RAB & Valuation)		submitted by TRANSCO	Regulatory Period using the ERC-approved WACC as that may be ascertained in the final determination
Chapter 6				
	Weighted Average Cost of Capital	NICAI	<p>We agree that the uncertainty of effects on the financial markets by recent fiscal policies may have a bearing on the final determination of the WACC. As such, the measure of regulatory WACC should use updated market data as late as possible in the regulatory reset process.</p> <p>The gearing ratio used by ERC of 50% may actually be unrealistic as would-be investors are currently dictated upon by financial institutions to have a 60%Equity – 40%Debt in the negotiation of loan portfolios.</p> <p>Our calculations point to a range of 17% to 19% WACC requirement if TRANSCO is privatized. While TRANSCO will still be in the hands of government until a franchise is granted to the concessionaire, ERC’s range of 14.76% to 16.12% may suffice. We therefore suggest a two-tiered WACC to jibe with the actual schedule of TRANSCO’s disposal.</p>	
6.1 – 6.21.3	Commission’s analysis of WACC	TRANSCO	The Applicants asked the Independent Expert on WACC, Professor Tony van Zijl to review chapter 6 of the Draft Determination. Professor van Zijl’s report is attached as <b>Attachment 21</b> .	Refer to recommendations of Professor van Zijl – see <b>Attachment 21</b>
6.14.3 (Page 92) and Table 6.7 (Page 93)	Regulatory WACC Estimate by ERC	CEPALCO	ERC provided a range of WACC figures.	We suggest that the ERC adopts the “mid” data sets for WACC calculations. This is to provide enough leeway for any upward or downward variances against the actual data
Sec. 6.11.15 and 6.11.16, page 89	Measurement of Benchmark Equity Betas (WACC)	FDC Cebu -	consistency necessitate the observance and use of the TWRG methodology in arriving at the applicable WACC for the Revenue Reset in the 2 <sup>nd</sup> Regulatory Period; accuracy within significant terms of the assets betas as stated in ERC Issues Paper and Draft Determination	adoption of the Hamada formula for de-levering and re-levering of the equity betas shall find application only after a thorough assessment of further empirical data; timely application on the 3 <sup>rd</sup> Regulatory Period as that recommended by ERC
Chap. 6, Sec. 6.14.4, page 92	Comparison of ERC’s and Independent Expert’s View (WACC)	FDC Cebu -	interests and dividends are <b>certain passive incomes</b> as defined by the National Internal Revenue Code (RA 8424, as amended), which have a different tax treatment from the normal corporate income tax rate	refer to Sec. 27 (D) (1), (3) and (4) of the National Internal Revenue Code (RA 8424, as amended) on how interests and dividends are considered

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
6.22	Timing of final WACC estimate	TRANSCO	The Applicants submit that WACC should be determined from data obtained as close as practical to the completion of the final decision of the Commission. The Applicants do not agree that market data for WACC must be derived as at end of January 2006.	WACC should be determined from parameters obtained as close as practical to the date of the final decision by the Commission.
Chap. 6, Sec. 6.22.2, page 99	Timing of Final WACC Estimate (WACC)	FDC - Cebu	market data available at the end of October 2005 shall be the input values in calculating for the regulatory WACC; the timelessness of utilizing such market data coincide with the publication of the Draft Determination	the assumption, as advanced by the ERC, of using the market data derived as at the end of January 2006, cannot be said to be a good approximation of the input parameters for WACC determination citing the spill-over of higher trading volume, which does not characterize the market activity for the rest of the year; hence, the October 2005 market data could be a better reference point especially in determining initial roll-forward values

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Chapter 7				
		NICAI		It is suggested that the ERC comes up with several simulations on this aspect and not just one. Again, a two-tiered WACC approach is suggested to arrive at the ARR. Though the WACC may increase upon full privatization, we can actually expect a substantial reduction in revenue requirements as private enterprise comes into the picture and implements a no-nonsense approach in cost reduction programs. Thus, ARR may not substantially change drastically even with a higher WACC in place midway of the regulatory period
7.1.2, 7.1.3 (p 100)	ERC model	TRANSCO	<p>The Commission states that a model has been developed of the TWRG revenue building block methodology and that this model “has provided the basis for the Draft Determination”. The ERC has not released a copy of its model. Without the model, the Applicants cannot be informed fully on the basis and rationale for all the proposed decisions. The Applicants request that the Commission provide an electronic copy of the model along with all supporting worksheets and input tables. See comments on section 1.3.1</p> <p>Without a copy of the model, the Applicants ability to comment on chapter 7 of the Draft Determination is seriously weakened.</p>	Please provide a copy of the model that has formed the basis for the Draft Determination
Chapter 7.2.2 (Page 100)	<p>ARR Analysis Transco/PSALM Approach</p> <p>...The primary assumptions used by Transco / PSALM for the estimate of the ARR for their filing are as follows:</p> <p>(a) A vanilla WACC of 21.98% pa (approximately 22% pa as applied for);</p>	MERALCO	ERC’s approved 15.44% vanilla WACC for Transco is more realistic and reasonable compared to the 22% applied for Transco. It is close to Meralco’s WACC figure of 15.93% in 2004.	Chapter 7.2.2 (Page 100)

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
Section 7.3.1 Page 104	WACC	NASECORE	The WACC of 15.44% that is used by the ERC for the estimate of Transco's annual revenue requirement (ARR) is too high considering that transmission business is a monopoly, is an almost risk-free business and is guaranteed an annual return. A WACC of 6% is appropriate under the circumstances.	
Section 7.3.1 (b)	Working Capital as percent of OPEX 2005 – 6% 2006 – 5% 2007 – 4% 2008 – 3% 2009 – 2.5% 2010 – 2%	TRANSCO	<p>Section 4.5.7 of the TWRG sets out the building block analysis used to determine the annual revenue requirement for TransCo. This formula includes an amount for working capital. The Issues Paper (paragraph 2.7.1) says that working capital “will be included in TRANSCO's revenue requirement to compensate it for the delay between those cash flows entering its business from customers and those leaving its business to suppliers. Such level of working capital should be set at a level which is reasonable for an efficient organization working as an electricity transmission company.”</p> <p>The TWRG specifies that the working capital allowance should be set at a proportion of the forecast operating and maintenance expenditure less bad debts. However, the TWRG does not specify a methodology. TransCo engaged an expert, Mr Paul Sell, to conduct a ‘first principles’ overview of working capital requirements; to review methods adopted in other jurisdictions; and arrive at a recommended methodology. A copy of Mr Sell's report is attached at <b>Attachment 22</b> Mr Sell recommended an assessment of leads and lags, a method suggested by the ERC in its Issues Paper. It is a method adopted by other regulatory authorities.</p> <p>TransCo applied the lead and lag methodology and determined the following results:</p> <p>Revenue Lag - 48.0 days Expense Lag - 20.2 days Net Lag - 27.8 days or 7.6% of operating and maintenance expenditure</p> <p>The ERC has provided no explanation of the method or basis it used to derive the percentages contained in the Draft Determination, nor any explanation as to why the Commission believes the working capital requirements will decline substantially over the regulatory period. The percentage figures adopted by the Commission appear arbitrary. The Applicants request the basis and rationale for the working capital estimates contained in the Draft Determination.</p>	The TransCo formula should be adopted in the entire regulatory reset period. TransCo submitted a very efficient working capital which is even less than one month. Other utility companies provided for two months working capital.
Sec. 7.3.1 and 7.3.3, pp 104-105	ERC's Approach and Outcome for the Draft Determination (ARR Analysis)	FDC - Cebu	working capital requirements shall gradually rise (as percentage of OPEX) towards 2007, before easing out on 2008 until 2010 which shall coincide with the programmed full-privatization of TRANSCO or the entry of a new concessionaire; justification necessary as to the ARR lag between 2005 and 2006 as per ERC analysis	recomputation of working capital requirements for the 1 <sup>st</sup> 2 years of the 2 <sup>nd</sup> Regulatory Period; revalidate ARR for 2006 as compared to 2005 value
7.3.1 (Page 104)	Primary assumptions used by ERC for the estimate of the ARR	CEPALCO	<ol style="list-style-type: none"> <li><b>On WACC:</b> Consistent with our comment on Section 6.14.3, we agree on the use of the mid-point WACC of 15.44%</li> <li><b>On Working Capital:</b> We would like to know the methodology used by ERC in arriving at the percentage levels of Working Capital, which is declining annually throughout the Regulatory Period, upon which TRANSCO gets a return on investment at the vanilla WACC.</li> </ol>	

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			If the methodology used is a lead-lag study as provided in the TWRG, may we be clarified on the reasons for the reduction in the percentage allowance for working capital over the Regulatory Years? If the reduction is due to the projected improved collection efficiency of TRANSCO (hence lower revenue lag), then we think that the reduction in the percentage of Working Capital allowance is a disincentive for TRANSCO to be efficient in their collection strategy.	
Section 7.4 Page 108	Treatment of Corporate Income Tax	NASECORE	Transco or its concessionaire should not be allowed to recover corporate income tax through its transmission rates. This contravenes the ruling of the Supreme Court that income taxes can not be allowed for rate determination purposes (Republic vs. Meralco and LAMP et. Al. vs. Meralco, (G.R. Nos. 141314 & 141369 dated 15 November 2002). In said case, the High Court ruled, thus: " The ERB correctly ruled that income tax should not be included in the computation of operating expenses of a public utility. Income tax paid by a public utility is inconsistent with the nature of operating expenses.	
7.4	Treatment of corporate income tax	TRANSCO	The ERC assumed that TransCo remains exempt from corporate income tax for 2006 and 2007.  It is currently expected that the privatization of TransCo will be completed by the end of 2006, with the concession awarded and franchise granted to the Concessionaire. The Concessionaire is expected to take over TransCo's business from 2007 onwards and be subject to corporate income tax. Therefore, an allowance for tax on regulated income should be included in determining the MAR for the regulated entity from 2007 onwards.	The ERC should assume TransCo to remain exempt from corporate income tax for 2006 only. TransCo's business will be owned by a taxable entity from 2007 onwards.
7.4.1 (p 108)	Timing of corporate income tax allowance	TRANSCO	The Draft Determination states that "in the 2008 year an income tax liability of PhP5,465 is assumed to accrue, which is also assumed to be paid in 2008". However, Figure 7.7 shows that TransCo is allowed to recover tax only in 2009 and 2010. Please clarify whether Section 7.4.1, as to the payment of 2008 corporate tax is compensated in 2008 as specifically provided here in the Draft Determination?	Please clarify timing of allowance for tax payments
7.5.1 (p 108)	Treatment of Other Taxes – for the Draft Determination, the ERC has assumed the other taxes which are required to be paid are zero.	TRANSCO	To assist the Commission understand the tax obligations of TransCo, the Applicants engaged an independent taxation expert Atty. Edmundo P Guevara to provide an opinion on the taxes that would be payable by TransCo and the Concessionaire. Atty Guevara's reports were attached as Annex F to the Application.  As the report from the tax expert attests, TransCo pays property taxes for transmission related properties that will eventually be transferred to TRANSCO. The requests that ERC provide a copy of its interpretation of tax law that supports its draft decision to remove 'other taxes' from the ARR.	Must be considered since these are valid business expense. (Pls check if these taxes not included in OPEX)
7.5.1 (p. 108)	The ERC has assumed the other taxes which are required to be paid at zero, as further analysis required.	TRANSCO	In the Draft Determination, ERC has not given due consideration on TransCo's historical payment of taxes, levies and duties, for each of the three calendar years preceding the 2 <sup>nd</sup> Regulatory Period. (Schedule 4 of Annex A of the application).  Actual payments of other taxes composed of the following:	

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			<p>a. Taxes and Duties  b. Realty Tax  c. Licenses</p> <p>TransCo is paying for the following taxes:</p> <p>a. Taxes and Duties –these are taxes paid for the imported materials and supplies purchased thru indent orders  b. Realty Tax – these are tax on real properties paid to local government units (LGUs) as mandated by the Local Government Code.  c. Licenses – payment to government agencies as a result of the required registration and licensing of transport vehicles and communication equipment.</p> <p>Attachment 23 provides for the detailed tax payments made by TransCo for the years 2003 - 2005</p> <p>The report of the tax expert on the following taxes and forecasts of TransCo should be given due consideration by the ERC:</p> <p>b. Local Business Tax - TransCo is subject to local business tax, by virtue of the withdrawal of tax exemption privileges of GOCC's under Section 193 of Republic Act No. 1760, otherwise known as the Local Government Code of 1991.</p> <p>c. Local Franchise Tax – The Supreme Court has ruled that the city government may validly impose a franchise tax on NPC (see City Government of San Pablo vs. Meralco and National Power Corporation vs. City of Cabanatuan). NPC is generating power and selling electricity in bulk, is deemed engaged in proprietary, not governmental, functions and is considered a business enjoying a franchise subject to local franchise tax. Accordingly, TransCo, in transmitting electricity, is likewise deemed engaged in proprietary functions and is therefore a business enjoying a franchise subject to local franchise tax.</p> <p>3. When the concessionaire takes place in year 2007 the following taxes should also be considered:</p> <p>a. Local Business tax - pursuant to Local Government Code the concessionaire is subject to local business tax.  b. Documentary Stamp Tax – the transfer of new projects will be subject to documentary stamp tax under Section 196 of the Tax Code.  c. Local Taxes – the transfer of these projects will also be subject to local transfer tax under Section 135 of the Local Government Code</p>	

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Chapter 8				
	Performance Based Regulation (Performance Incentive Scheme)	NICAI	<p>We agree to ERC’s proposed Performance Measures as drafted and we note that these are the “deterministic” types as they measure desired responses to system disturbances. We likewise confirm that the previous measures used were not applicable to a transmission company and that previous figures presented based on the old measures were meaningless. Aside from annual determination of such new indices, there should be interim reportorial requirements on a monthly and quarterly basis.</p> <p>The measures are however limited only to measure performance in relation to abnormalities occurring in the transmission system. They do not take into account constructively measures of adequacy which in turn signals the need for “probabilistic” types of measures to predict the likelihood that all demand will be served. Examples of which include whether or not the facilities meet N-1 criteria or if transfer capability is adequate for existing generation facilities. We suggest targets of accomplishment tied to agreed-upon completion dates.</p> <p>Another basic responsibility which TRANSCO is tasked to do is the provision of Ancillary Services. As to whether or not such services have been or will be amply provided shall still have to be determined on a regular basis.</p>	
Chapter 8.3 (Page 111)	Proposed Performance Indicators (PI)	MERALCO	The five PI proposed by Transco are all technical measures (SISI, FLC, VLC, FOT, and SA).	ERC should also add the following three (3) customer service related PI since Transco is a national monopoly: Average Response Time to DU Impact Study, Average Response Time to DU Connection Point Energization, and Average Response Time to DU Operating Complaint Resolution.
8.3.6 #1 (Page 113)	System Interruption Severity Index (SISI)	CEPALCO	<p>We believe that the use of “System Peak Load”, whether non-coincident or coincident, as the denominator for SISI formula leads to inaccurate or non-reflective number of minutes of interruption. Consider a case where the System Peak Load of an entity billed by Transco is 100 MW and its load factor is 60%. Supposing, for the sake of illustration, that the actual interruption took 15 days (or 21,600 minutes) in a billing month. Applying the proposed formula would yield,</p> $\text{SISI} = (100 \times 0.6 \times 720 \times 0.5) / 100 = 216 \text{ hours or } 12,960 \text{ minutes.}$ <p>The result, therefore, is only 60% of the actual interruption time in this example. The same argument holds true for any billing period duration.</p> <p>Whereas, if the Average System Load is used in the denominator, the result will be:</p> $\text{SISI} = (100 \times 0.6 \times 720 \times 0.5) / (0.6 \times 100) = 360 \text{ hours or } 21,600 \text{ minutes}$	Suggest that the denominator of the formula for SISI be changed to “Average System Demand” instead of “System Peak Load”.

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8.3.5 (Page 113)	System Loss	CEPALCO	<p>TRANSCO should not exclude Transmission System Loss in its proposed Performance Indicators (PIs), for 2 reasons:</p> <p>(1) In the transition period towards WESM, TRANSCO is the owner of the transmission system and so it is its mandate to maintain the efficiency of the transmission system;</p> <p>(2) Removing System Loss in the PIs for Transco would not encourage the latter to invest more on transmission project reinforcements. The end result, we believe, will be the tendency of the transmission system to become congested given the load increases (and other dynamic factors) in the grid. Transmission congestion will be a problem especially when WESM will be implemented.</p>	TRANSCO should include Transmission System Loss in its proposed Performance Indicators (PIs).
Chapter 8.3.5 (Page 113)	<p>Proposed Performance Indicators System Loss was omitted from the list and replaced with System Availability. Transco argues that Technical losses, which constitute the bulk of the system losses, are beyond its control. These losses depend heavily on the location of generating plants supplying power to the load centers. The nearer the generating plants that are supplying load to the load center the lower will be the system losses. To replace Systems Loss, Transco considered System Availability as an internationally used performance measure.</p>	MERALCO	<p>Although losses are greatly affected by location of the generating plants and loads, Transco can lower losses by the optimal placement of capacitors at different times of the day. Transco might not be able to justify such installation of capacitors to reduce losses if system loss would not be included as a performance indicator.</p> <p>The 2.98% loss being used by Transco might have included losses from subtransmission and distribution losses up to the metering point between Transco and its customers. Pure transmission losses from loadflow simulations are less than 2%. Losses might still go down with increasing loads near the power plants</p>	Chapter 8.3.5 (Page 113)

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Chapter 8.3.6.5 (Page 114)	<p>Proposed Performance Indicators</p> <p>Voltage Limit Compliance (VLC) – refers to the percentage of the number of voltage measurements during the rating period that the voltage variance did not exceed <math>\pm 5\%</math> of the nominal voltage of all busses (Luzon – 230 kV &amp; 500 kV, Visayas – 230 kV/138 kV, Mindanao – 138 kV) monitored at the high side of the substation.</p>	MERALCO	--	It is suggested that the monitoring be up to the metering point between Transco and the customer.
Chapter 8.8.4 (Page 121)	<p>ERC's Approach on the Performance Measures</p> <p>The ASIFI, MAIFI and ASIDI were suggested to be excluded in the list of PIS because these indices were intended for distribution system, substations, circuits and defined regions. This was based on IEEE Std. 1366-2001 "IEEE Guide for Electric Power Distribution Reliability Indices".</p>	MERALCO	Transco deleted these, with ERC's tentative approval, on the premise that these parameters are applicable only to DUs.	For as long as Transco has radial lines not yet divested to DUs (mostly, but not limited to, 69 kV lines), it should be subject to ASIFI, MAIFI and ASIDI.

Article/Section No.(page)	Section Title/subject Matter of Concern	Stakeholder	Discussion of Comments and./or Questions for Clarification	Suggestions/Proposed Change(s)
8.8.18 #4 (Page 125)	Deadband High Limit Value has already exceeded the maximum measure	CEPALCO	This may discourage further improvement in the operation of the transmission system.	Set the reward cut-off point equal to the maximum measure.
Sec. 8.8.23, page 128	ERC's Approach on the Weightings (PBR)	FDC - Cebu	the weightings per grid for the performance indicators shall be determined by load density, system peak demand and quantity of transmission assets rather than in the proportional average performance	re-evaluation of the load density, system peak demand and quantity of transmission assets per grid area
Sec. 8.9.2 and 8.9.3, page 129	Adjustment Process (PBR)	FDC - Cebu	reward or penalty imposed by Performance Incentive Scheme has similar effect of trigger events that would reopen the MAR for adjustments in an annualized basis	streamline difference in treatment of the effects of reward or penalty under the PIS and trigger events resulting to reopening or adjustments to the MAR
General Comment /Others				
		NICAI	The preparation of a draft determination as part of the process of determining rates is a very much welcomed approach for pre-determining what power rates a regulated utility may apply on its customers. We fully agree to the approach that is designed to afford other stake holders and the applicant itself an opportunity to comment on the ERC's views before a final decision is made. We sincerely pray that the same approach be adopted for power rate cases for other regulated entities especially distribution utilities.	
		NICAI	The ERC has to finalize approval of the Connection Charging Policy before it makes a final determination of rates under the TWRG. The draft determination already assumes connection charging to be in place. The approval of such policy is necessary to support ERC's final determination otherwise, the adjustments involving removal of asset and capex projects from the Capex Forecast become unfounded	