

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

**PROPOSED AMENDED GUIDELINES FOR THE SETTING OF ELECTRIC
GENERATION RATES AND SUBSIDIES FOR MISSIONARY
ELECTRIFICATION IN AREAS**

Pursuant to Sections 34 and 43(t) of Republic Act No. 9136, otherwise known as the Electric Power Industry Reform Act of 2001 (EPIRA), and its Implementing Rules and Regulations (IRRs), and in view of Sec. 70 of the EPIRA and Department of Energy (DOE) Circular No. DC 2004-01-001 (NPC-SPUG Circular), the Energy Regulatory Commission (ERC) hereby adopts and promulgates these Guidelines for the setting of electricity generation rates and subsidies for Missionary Electrification areas currently or previously supplied by NPC-SPUG.

ARTICLE I

General Provisions

Section 1. Objectives. - These Guidelines shall be used to set electricity generation rates and subsidies for areas not connected to the transmission system and where NPC-SPUG renders Missionary Electrification by providing power generation and its associated power delivery systems

Section 2. Definition of Terms. -

(a) “Best New Entrant Rate” shall refer to the generation rate, expressed in Peso per Kilowatt-hour, which would need to be charged by an efficient entrant to cover its costs and earn a reasonable return on capital;

(b) “Competitive Selection Process” or **“CSP”** shall refer to the formal steps, such as bidding or the canvassing of proposals, undertaken by an Electric Cooperative (EC) to secure an NPP that can meet the EC’s power supply needs at lowest cost, while also being responsive to the required supply timetable, the urgency of need and other factors beneficial to the EC.

A CSP would be deemed to have succeeded if the EC receives at least two (2) comparable proposals from unrelated companies. Proposals would be considered comparable if these offer the EC a comparable output; for example, the same net guaranteed capacity over a defined

period of time. The competitive selection would be deemed to have failed if the EC receives only one proposal, or if it receives two (2) or more proposals that are not comparable.

If a CSP is deemed to have failed, the EC may decide to repeat it until it succeeds.

The DoE will endorse the CSP undertaken by the EC upon the submission by the EC of a certification with the corresponding evidence that the EC's CSP succeeded or failed in accordance with this definition and with the guidelines set by DOE;

(c) “Delegated NPC-SPUG Area” shall refer to an area that is not connected to the transmission system where NPC-SPUG, through the NPPs, is providing electric generation services;

(d) “Department of Energy” or **“DOE”** shall refer to the term defined in Section 4(k) of the EPIRA;

(e) “Distribution Utility” or **“DU”** shall refer to the term defined in Section 4(q) of the EPIRA;

(f) “Electric Cooperative” or **“EC”** shall refer to the term defined in Section 4(r) of the EPIRA;

(g) “Energy Regulatory Commission” or **“ERC”** shall refer to the term defined in Section 4(v) of the EPIRA;

(h) “EPIRA” shall refer to Republic Act No. 9136, otherwise known as the “Electric Power Industry Reform Act”;

(i) “IRRs” shall refer to the Implementing Rules and Regulations of the EPIRA;

(j) “Missionary Electrification” shall refer to missionary electrification functions mandated to NPC-SPUG under Section 70 of EPIRA, including the responsibility of providing power generation and its associated power delivery systems in areas that are not connected to the transmission system;

(k) “Missionary Electrification Universal Charge” or **“UC-ME”** shall refer to the Missionary Electrification component of the Universal Charge, expressed in Peso per Kilowatt-hour, determined, fixed and approved by the ERC and applied to all electricity end-users, and defined in Section 34 of the EPIRA;

(l) “Missionary Electrification Subsidy” shall refer to the subsidy, expressed in Peso per Kilowatt-hour, approved by the ERC, whose ultimate beneficiaries are end-users in missionary areas, and that will be calculated as the difference between a True Cost Generation Rate, or NPC-SPUG True Cost of Generation, and a Socially Acceptable Generation Rate. The Missionary Electrification Subsidy is to be petitioned by NPC-SPUG, and funded from the UC-ME;

(m) “NPC-SPUG” shall refer to the term defined in Section 4 (tt) of the EPIRA;

(n) “NPC-SPUG Area” shall refer to an area not connected to the transmission system that NPC-SPUG directly provides or will provide electric generation services;

(o) “NPC-SPUG True Cost of Generation” shall refer to the cost, expressed in Peso per Kilowatt-hour, that includes all NPC-SPUG allowable expenses incurred from providing electric generation services in all NPC-SPUG Areas;

(p) “NPP” shall refer to the term New Private Provider as defined in the DOE NPC-SPUG Circular, and except as provided herein is understood to be the same as the term “IPP” under the Rule 4(tt) of the IRRs;

(q) “Power Supply Agreement” or “PSA” shall refer to the agreement entered into between a New Private Provider and a EC for the supply of electricity;

(r) “Power Sector Assets and Liabilities Management Corporation,” “PSALM” or “PSALM Corp.” shall refer to the corporation created pursuant to Section 49 of the EPIRA;

(s) “Socially Acceptable Generation Rate” or “SAGR” shall refer to the generation rate, expressed in Peso per kilowatt-hour, that the ERC has determined to be socially acceptable for an EC to pay for electric generation services, and pass on to its consumers, within its franchise area;

(t) “Subsidy Agreement” or “SA” shall refer to the agreement amongst the EC, NPP and NPC-SPUG for a particular Delegated NPC-SPUG Area, pursuant to the NPC-SPUG Circular, Section 5(a)(1)(3);

(u) “Renewable Energy” shall refer to energy generated from resources that do not have an upper limit on the total quantity to be used. Such resources are renewable on a regular basis and the

renewable rate is rapid enough to consider availability over an indefinite time. These resources include, among others, biomass, solar, wind, geothermal, hydro and ocean energy;

(v) “Term of Power Supply Agreement” shall refer to the period of commercial operations of the Power Supply Agreement;

(w) “Transition Period” shall, in the case of the Delegated NPC-SPUG Areas, refer to the period of time over which the SAGR will increase from its current value to the TCGR; and in the case of the NPC-SPUG Areas, to the period of time over which the SAGR will increase from its current value to the NPC-SPUG True Cost of Generation;

(x) “Transition Index” shall refer to the index at which the Socially Acceptable Generation Rate for a particular NPC-SPUG or Delegated NPC-SPUG Area should increase, over and above other inflation or foreign exchange based indices, to reach the True Generation Cost Rate, or NPC-SPUG True Cost of Generation, by the last day of the Transition Period;

(y) “True Cost Bid Generation Rate” shall refer to the rate offered by a potential NPP and computed based on the True Cost Generation Rate Bid Parameters;

(z) “True Cost Generation Rate Bid Parameters” shall refer to the parameters defined in the bid documents, such as capacity and variable energy rate or fuel conversion rate, and for which specific values would be defined in the offers of potential NPPs interested in taking over supply in a Delegated NPC-SPUG Area. The True Cost Bid Generation Rate would be computed based on these parameters;

(aa) “True Cost Generation Rate” or “TCGR” shall refer to the rate, expressed in Peso per Kilowatt-hour, that recovers the NPP’s efficient costs of generation during a particular period or date. The TCGR must be sufficient to allow the recovery of just and reasonable costs and a reasonable return on investment to enable the NPP to operate viably. In the case of multiple NPPs supplying a single EC, or a joint supply of one or more NPPs and NPC-SPUG, the TCGR shall refer to the total blended cost of generation, including the TCGR of the NPP (s) and the NPC-SPUG True Cost of Generation for that NPC-SPUG Area;

(bb) “Universal Charge” shall refer to the term defined in Section 4 (ddd) of the EPIRA;

(cc) “**Variable Generation Rate**” shall refer to the generation rate component, expressed in Peso per Kilowatt-hour, that recovers variable generation costs, such as fuel or bunker oil,.

Section 3. Scope. – These Guidelines shall be applicable to NPPs that serve Delegated NPC-SPUG Areas, as well as NPC-SPUG, while NPC-SPUG continues to operate in NPC-SPUG Areas.

ARTICLE II

Provisions Applicable Only to Delegated NPC-SPUG Areas

Section 1. Rules for Setting and Adjusting True Cost Generate Rate. - In each of the Delegated NPC-SPUG Areas, the NPPs shall be allowed to recover the TCGR. The Socially Acceptable Generation Rate combined with the Missionary Electrification Subsidy should equal the TCGR.

For the purposes of these Guidelines, the TCGR for a particular Delegated NPC-SPUG Area shall be:

(a) The lowest True Cost Bid Generation Rate offered by an NPP for that Delegated NPC-SPUG Area, as certified by the EC and endorsed by DOE (in accordance with the definition provided in Article I, Section 2 (b)), following a CSP to ensure the lowest long-term cost of power and services, environmental compatibility with the local area, most advantageous implementation schedule and faster elimination of the ME Subsidy; or

(b) Should there be a failure of a CSP as certified by the EC and endorsed by DOE, the TCGR for that Delegated NPC-SPUG Area shall be the Best New Entrant Rate, which is to be developed by the ERC, or any other lower rate that an NPP is agreeable to charge. If the NPP is unwilling to accept the Best New Entrant Rate, and requires a higher rate that is acceptable to the EC, the EC can file a petition for a reconsideration with the ERC with all the necessary evidence to prove that a higher rate than the Best New Entrant Rate is needed.

The ERC will determine the Best New Entrant Rate prior to the CSP. The determined Best New Entrant Rate will be stored in a sealed envelope which will only be opened if the CSP fails, and the Best New Entrant Rate is required as a benchmark.

To promote the use of Renewable Energy, the EC will design bidding parameters that give preference to offers that rely entirely or partially on Renewable Energy.

The TCGR during a specific period will be determined based on the provisions of the PSA, to set basis for the automatic adjustments.

The EC shall file an application, in accordance with Article II Section 3(a) of these Guidelines, to petition ERC to approve the TCGR and the PSA.

Section 2. Rules for Setting and Adjusting Socially Acceptable Generation Rates, and the Missionary Electrification Subsidy for Delegated NPC-SPUG Areas. – Upon the Issuance of these Guidelines all the generation rates approved by the ERC to be charged by NPC-SPUG to ECs would be termed Socially Acceptable Generation Rates (SAGR).

- (a) When the TCGR for a particular Delegated NPC-SPUG Area is higher than the SAGR, ERC will allow the concerned end-users to benefit from a ME Subsidy, funded from the Universal Charge, that will cover the difference between the TCGR and SAGR;
- (b) When the TCGR for a particular Delegated NPC-SPUG Area is lower than the SAGR, ERC will consider that Delegated NPC-SPUG Area as no longer requiring a ME Subsidy, and the generation rate to be paid by the EC will be set at the TCGR;
- (c) The ERC may decide that the SAGR should increase based on a Transition Index, in line with the expected development of such Delegated NPC-SPUG Area. The Transition Index and frequency of this increase, if applicable, would be determined by the ERC based on the methodology described in Annex I, and as part of its Decision on the TCGR and approval of PSA referred to in Article II, Section 1 of these Guidelines.

The SAGR for a particular Delegated NPC-SPUG Area will be automatically adjusted over time in the same proportion and frequency as the TCGR, in accordance with Article II Section 1 of these Guidelines, using the methodology and formulas described in Annex I and the provisions of the ERC Approved PSA for that particular Delegated NPC-SPUG Area.

Fluctuations in the SAGR, as a result of the application of formulas in Annex II, will be automatically passed through to the final rate charged by the EC to end-users in that particular Delegated NPC-SPUG Area.

Increases in the SAGR as a result of the application of the Transition Index would result in a decline in the ME Subsidy for such Delegated NPC-SPUG Area. When the SAGR for a particular Delegated NPC-SPUG Area, as

a result of the application of the Transition Index, is equal to or higher than the TCGR for such Delegated NPC-SPUG Area, that Delegated NPC-SPUG Area will no longer be considered as an area requiring a ME Subsidy.

NPP shall submit, to the entity designated by NPC-SPUG as administrator of the subsidy, periodic invoices for the ME Subsidy. The ME Subsidy that the NPP shall invoice, would be calculated as the TCGR minus the SAGR, multiplied by the units of electricity generated during the invoicing period, subject to the terms of PSA and Subsidy Agreement (SA), and paid on the basis of outputs (i.e. energy delivered).

Section 3. TCGR Filing Requirements and Procedures. – The following requirements and procedures should be followed in the submission, evaluation and approval of the TCGR:

(a) **Notice of Launch of CSP** – 30 days before the issuance of invitation to bid for the CSP for a particular Delegated NPC-SPUG Area, the respective EC would notify ERC and DOE of the date of the launch. This notification will include:

- i. A copy of the bidding documents that would be used for the CSP;
- ii. A copy of the PSA that would be signed with the winning NPP, which should specify the expected output that the supplier should provide; for example, net guaranteed capacity over a defined period of time;
- iii. A copy of, if available, of a due diligence report of the EC and the NPC-SPUG generation plants;

After receiving this notice, the ERC would proceed to determine the Best New Entrant Rate for that NPC-SPUG Delegated Area, and store it in accordance to Article I Section 1(b).

Should the CSP had been launched before or within 30 days after the issuance of these Guidelines, the EC would be exempt from having to notify ERC, and ERC would determine the Best New Entrant Rate if and when it receives an application from the EC to set the TCGR.

(b) **TCGR Setting After Successful CSP** – Following the completion of a successful CSP and award of the PSA to an NPP, the concerned EC will file an application with the ERC to petition for the approval of the TCGR resulting from the CSP and the PSA to be signed with the winning NPP. This application should include:

- i. A letter certifying that the NPP was selected following a CSP;
- ii. A letter from DOE endorsing the CSP;

- iii. The schedule of TCGR Bid Parameters offered by the NPP which were used to determine the True Cost Generation Bid Rate;
- iv. A copy of the signed PSA and other supporting contracts and agreements;

ERC's Decision on the approval of the TCGR will be exclusively based on its satisfaction that the CSP was conducted in accordance with the definition in these Guidelines and on receiving DOE's endorsement of the process. The TCGR determined through a CSP conducted to the satisfaction of ERC would be deemed as being fair and reasonable.

ERC's Decision on the approval of the Power Supply Agreement will be based on its satisfaction that:

- i. The rate set in the PSA is fair and reasonable;
- ii. The NPP is required to supply electricity in accordance with the applicable technical, financial and environmental standards, as well as with the outputs defined in the bidding documents ¹;
- iii. NPPs compliance with the applicable standards is guaranteed by a reasonably valued performance bond or other forms of financial guarantee;
- iv. Risks associated with the PSA are efficiently allocated and managed.

The ERC will issue a Decision approving the TCGR and PSA within [XX] days from receipt of the EC's petition. This Decision will also include, if applicable, the Transition Index for that particular Delegated NPC-SPUG Area.

(c) TCGR Setting After Failure of CSP - Should there be a failure of a CSP, as defined in these Guidelines, the EC will file an application with the ERC to petition for the setting of the TCGR for the concerned Delegated NPC-SPUG Area. This application will include:

- i. A copy of the offer submitted by the single bidder;
- ii. A copy of the signed PSA and other supporting contracts and agreements.

The ERC will set the TCGR at the Best New Entrant Rate previously determined by ERC for that Delegated NPC-SPUG Area, or

¹ While the ERC has not issued reliability standards specifically applicable to off-grid generators and offtakers, ERC will consider that off-grid generators and offtakers are not required to comply with the Single Outage Contingency criterion as defined in the Philippine Distribution Code (specifically the outage of the largest running generating unit), and that an acceptable level of reliability would be a contingency reserve of 20%.

any other lower rate that an NPP has offered to charge, or any other rate agreed between the ERC, EC and the NPP.

ERC will issue a Decision setting the TCGR and approving the PSA within XX days of the filing to the satisfaction of the ERC. This Decision will also include, if applicable, the Transition Index for that particular NPC-SPUG Area.

(d) **Setting of Transmission Rate** - Prior or in parallel to filing for the TCGR, the EC will file, if applicable, an application with the ERC petitioning for the setting of a Transmission rate that covers the additional cost of leasing, acquiring, operating and / or maintaining the sub-transmission assets previously owned by NPC-SPUG, and which the EC will need to have possession and operational control before the effective date of the PSA.

ARTICLE III

Provisions Applicable Only to NPC-SPUG Areas

Section 1. Rules for Setting and Adjusting NPC-SPUG True Cost of Generation. - In each of the NPC-SPUG Areas, NPC-SPUG shall be allowed to recover the NPC-SPUG True Cost of Generation.

For the purposes of these Guidelines, the NPC-SPUG True Cost of Generation shall be that amount, expressed in Pesos per Kilowatt-hour, that ERC determines to be fair and reasonable for NPC-SPUG to cover all its cost of generating electricity in all NPC-SPUG Areas. ERC would make this determination as a Decision on an application filed by NPC-SPUG, in accordance to Article III, Section 3 of these Guidelines.

The NPC-SPUG True Cost of Generation will be adjusted in calendar quarters starting with the first calendar quarter after the issuance of these Guidelines, based on GRAM and ICERA adjustments that ERC would approve in response to an application filed by NPC-SPUG with the ERC for this matter. The NPC-SPUG True Cost of Generation will also be adjusted at the most every two years to reflect fluctuations in other fixed and variable costs not included in the GRAM and ICERA adjustments.

The NPC-SPUG True Cost of Generation will also be adjusted, at the same time as the GRAM and ICERA adjustments referred to in the previous paragraph, if and when an NPC-SPUG Area is delegated to an NPP. An NPC-SPUG Area will be considered as delegated to an NPP when ERC approves the TCGR to be applied in that Delegated NPC-SPUG Area.

In the case of NPC-SPUG Areas in which there is a joint supply electricity by an NPP and by NPC-SPUG, NPC-SPUG will petition the ERC to set a NPC-SPUG True Cost Generation Rate for that particular Area. In such cases, the TCGR for that Area will be computed as the blended cost of all sources of electricity.

Section 2. Rules for Setting and Adjusting Socially Acceptable Generation Rates, and the Missionary Electrification Subsidy for NPC-SPUG Areas. –Upon the issuance of these Guidelines all the generation rates approved by the ERC to be charged by NPC-SPUG to ECs shall be deemed the Socially Acceptable Generation Rates (SAGR).

When the NPC-SPUG True Cost of Generation for a particular NPC-SPUG Area is higher than the SAGR, ERC will allow the concerned end-users to benefit from a ME Subsidy, funded from the Universal Charge, that will cover the difference between the NPC-SPUG True Cost of Generation and SAGR.

When the NPC-SPUG True Cost of Generation for a particular Delegated NPC-SPUG Area is lower than the SAGR, ERC will consider that Delegated NPC-SPUG Area as no longer requiring a ME Subsidy, and the generation rate to be paid by the EC will be set at the NPC-SPUG True Cost of Generation.

The ERC may decide that the SAGR should increase based on a Transition Index, in line with the expected development of such NPC-SPUG Area. The Transition Index and frequency of this increase, if applicable, would be determined by the ERC based on the methodology described in Annex I, and as part of its Decision on the NPC-SPUG True Cost of Generation referred to in Article III, Section 1 of these Guidelines.

The SAGR for a particular NPC-SPUG Area will be automatically adjusted over time in the same proportion and frequency as the NPC-SPUG True Cost of Generation, per Article III, Section 1 of these Guidelines, using the methodology and formulas described in Annex II. In the case of NPC-SPUG Areas which have a joint supply with an NPP, the SAGR would be adjusted based on the fluctuations in the blended cost of generation.

Fluctuations in the SAGR, as a result of the application of formulas in Annex II, will be automatically passed-through to the final rate charged by the EC to end-users in that particular NPC-SPUG Area.

Increases in the SAGR as a result of the application of the Transition Index would result in a decline in the ME Subsidy for such NPC-SPUG Area.

When the SAGR for a particular NPC-SPUG Area is equal to or higher than the NPC-SPUG True Cost of Generation for such NPC-SPUG Area, that NPC-SPUG Area will no longer be considered as requiring a ME Subsidy.

Section 3. NPC-SPUG True Cost of Generation Filing Requirements and Procedures. – The following requirements and procedures should be followed in the submission, evaluation and approval of the NPC-SPUG True Cost of Generation and Transition Index for all NPC-SPUG Areas

(a) **Base NPC-SPUG True Cost of Generation** - Before or within 30 days of the approval of these Guidelines, NPC-SPUG will file an application with the ERC to petition for the approval of the NPC-SPUG True Cost of Generation. This petition could be jointly filed with the UC-ME petition, as described in Article IV Section 1 of these Guidelines.

The NPC-SPUG True Cost Generation Rate will represent the revenue requirement of NPC-SPUG in accordance with the Return on Rate Base (RORB) methodology used to determine NPC's generation charges. To support the computation of this revenue requirement, NPC-SPUG will submit as part of the application the following information:

- i. Current NPC-SPUG operating and maintenance costs, including disaggregated fuel purchase and delivery, payroll, power purchase, depreciation and other costs;
- ii. Current value of NPC-SPUG's assets; and
- iii. Current energy sales;

The ERC will issue a Decision approving the NPC-SPUG True Cost of Generation for all NPC-SPUG Areas. This Decision will also include, if applicable, the Transition Index for particular NPC-SPUG Areas.

(b) **GRAM and ICERA Adjustments to NPC-SPUG True Cost of Generation** - Every calendar quarter after the approval of these Guidelines, NPC-SPUG will file with the ERC a petition to adjust the NPC-SPUG True Cost of Generation based on the application of the GRAM and ICERA mechanisms. This petition will be supported by all documentation required by the ERC rules and Guidelines on this matter. The ERC will issue a Decision approving the NPC-SPUG True Cost of Generation that results from the application of the approved GRAM and ICERA adjustments.

(c) **Other Adjustments to NPC-SPUG True Cost of Generation** – On or before September 30 of every other calendar year, starting two calendar year after the issuance of these Guidelines, NPC-SPUG will

file an application with the ERC to petition for the resetting of the Base NPC-SPUG True Cost of Generation as a result of cost fluctuations not reflected by GRAM and ICERA adjustments;

ARTICLE IV

Provisions Applicable to Delegated NPC-SPUG Areas and NPC-SPUG Areas

Section 1. UC-ME Filing Requirements and Procedures. - The following requirements and procedures should be followed in the submission, evaluation and approval of the UC-ME for Delegated NPC-SPUG Areas and NPC-SPUG Areas (“All NPC-SPUG Areas”).

(a) **Periodic Filing.** – On or before September 30 of every calendar year, NPC-SPUG will file a petition with ERC to set the UC-ME sufficient to cover ME Subsidy estimated requirements for All NPC-SPUG Areas in the forthcoming calendar year. These estimates will be computed as follows:

	Estimated ME Subsidy Requirements	Formula
1	ME Subsidy for Delegated NPC-SPUG Areas (PhP) (1)	Sum for all Delegated NPC-SPUG Areas of (TCGR – SAGR) x forecasted sales (kWh)
2	ME Subsidy for NPC-SPUG Areas (PhP) (2)	(NPC-SPUG True Cost of Generation – SAGR) x forecasted sales for NPC-SPUG Areas kWh)
3	ME Subsidy for other Missionary Electrification uses (PhP)	
4	Total (PhP)	[1 + 2 + 3]
5	Safety Margin (PhP) (3)	[(SM x 4)/100]
6	Forecasted National Electricity Sales (kWh) (4)	
7	UC-ME (PhP / kWh)	[5 / 6]

Notes:

- a) The TCGR and SAGR will be obtained from the most recent subsidy invoice paid to each NPP. Forecasted sales will be obtained from the concerned EC
- b) The NPC-SPUG True Cost and SAGR would be obtained from the latest ERC Decision on GRAM and ICERA, or other cost adjustments. Forecasted sales will be obtained from NPC-SPUG’s own forecasts
- c) NPC-SPUG would use a safety margin (SM) of 5% to compensate for potential UC-ME collection shortfall, higher energy sales in NPC-SPUG areas or lower national sales
- d) Forecast national electricity sales will be obtained from DOE’s Philippine Power Development Plan

- e) "ME Subsidy for other Missionary Electrification uses" shall also include any transmission related and/or associated delivery service subsidies for the SPUG areas.

The ME Subsidy Requirements included in the above table should be consistent with the ERC approved Missionary Electrification Development Plan (MEDP). If the MEDP has not been approved by the time NPC-SPUG files the UC-ME application, a later reconciliation would be made between the ME Subsidy forecasted in the MEDP and in the table above.

ERC will issue a Decision setting the UC-ME for the forthcoming calendar year at a value, expressed in Pesos per Kilowatt-hour, that when multiplied by the expected national electricity sales, will equal the estimated ME Subsidy requirements of all NPC-SPUG Areas. All the funds collected by PSALM from the application of the UC-ME, regardless of the absolute Peso amount, will be transferred to NPC-SPUG. This Decision will indicate the share of the UC-ME that is approved for Delegated NPC-SPUG Areas, NPC-SPUG Areas and other Missionary Electrification uses.

(b) Administration of UC-ME Funds. – Prior to the commencement of CY2006, NPC-SPUG will establish a trust account – NPC-SPUG UC-ME Account – where all UC-ME transfers from the PSALM administered Special Trust Fund will be deposited. This bank account would be governed by a set of predefined guidelines rules. The administrator of the account will make transfers to NPC-SPUG, or NPP, according to such guidelines . In the case of NPP, transfer rules from the account administrator would also be defined in the Subsidy Agreement to be signed between the NPC-SPUG, NPP and the EC. In the case of NPC-SPUG Areas with a joint NPP and NPC-SPUG supply, the Subsidy Agreement will specify how the ME Subsidy will be shared between the NPP and NPC-SPUG.

(c) Reconciliation of Actual UC-ME. – The amount of UC-ME petitioned in accordance to Article IV, Section 1(a) represents the Expected ME Subsidy requirement for the NPC-SPUG Areas for the forthcoming calendar year. The Actual ME Subsidy required could be higher or lower depending on the actual volume of generation sales and if NPC-SPUG Areas are delegated to NPPs. NPC-SPUG shall reconcile the ME Subsidy approved with the Actual ME Subsidy disbursed to the NPP or used by NPC-SPUG during the calendar year. Any surplus would be subtracted from the ME Subsidy application for the subsequent calendar year. An example of how this reconciliation would be made is presented in Annex III. In the case of an expected deficit in the ME Subsidy during a calendar year, ERC would expect NPC-SPUG to file an application for an adjustment in the UC-ME.

(d) **Automatic Adjustment to UC-ME.** – If as a result of factors outside their control, NPC-SPUG is unable to file an acceptable UC-ME application before September 30, or the ERC is unable to issue a UC-ME Decision before the end of the Calendar Year, the UC-ME approved by the ERC for the previous calendar year will be automatically adjusted based on the following formula and events:

$$UCME_t = UCME_{t-1} \times AF_t$$

Where:

- t = Forthcoming year
- t-1 = Current year
- UCME_{t-1} = UC-ME (PhP/kWh) approved for the current year

AF_t

If NPC-SPUG fails to file an acceptable UC-ME application with the ERC before September 30 of the current year:

- = 0.5 when t = 2006
- = 0.6 when t = 2007
- = 0.7 in all other subsequent years

If ERC is unable to issue a UC-ME Decision December 31 of the Current Year:

- = 1.0

(d) **Transitory Provisions.** – Considering that at the time these Guidelines were issued NPC-SPUG has a pending application with the ERC (ERC Case 2004-449) petitioning for the approval of the UC-ME for 2005 for the 14 first wave Areas which are proposed to be Delegated NPC-SPUG Areas, the following special provisions will apply for the UC-ME petition for All NPC-SPUG Areas for 2005:

- i. ERC will make a Decision on this application Case 2004-449 setting the UC-ME that NPC-SPUG should allocate to these 14 to-be Delegated NPC-SPUG Areas. This UC-ME will be defined in PhP/kWh;
- ii. The amount approved for the 14 to be Delegated NPC-SPUG Areas will be allocated from the current ERC approved UC-ME for all NPC-SPUG Areas of PhP 0.0373/kWh;
- iii. NPC-SPUG will be required to file before or within 30 days of the issuance of these Guidelines, an application petitioning the ERC to set the UC-ME for the remaining 60 NPC-SPUG Areas. This UC-ME will be defined in PhP/kWh;
- iv. The UC-ME amount approved by ERC for the remaining 60 NPC-SPUG Areas will be added to that approved for the 14 to-be Delegated NPC-SPUG Areas to obtain the total UC-ME.

Furthermore, NPC-SPUG shall continue to collect the ERC-approved Deferred Accounting Adjustment (DAA) within the prescribed recovery period.

Annex I – Methodology to Determine Transition Index and Transition Period for NPC-SPUG Areas and Delegated NPC-SPUG Areas

This Annex describes the methodology that ERC will use to determine the Transition Index and Transition Period for NPC-SPUG Areas and for Delegated NPC-SPUG Areas (“All NPC-SPUG Areas”).

The premises on which this methodology is based are:

- It is a priority for the Government to reduce the burden on all electricity end-users contributing to the Universal Charge
- The UC-ME funded ME Subsidy could be decreased over time, as affordability of end-users improves
- Improvements in affordability of higher generation rates are aligned with improvements in the economic development of an area.

Accordingly, in order to phase-out the ME Subsidy over time, the SAGR should increase over time to reflect the expected improvements in the economic development of the area.

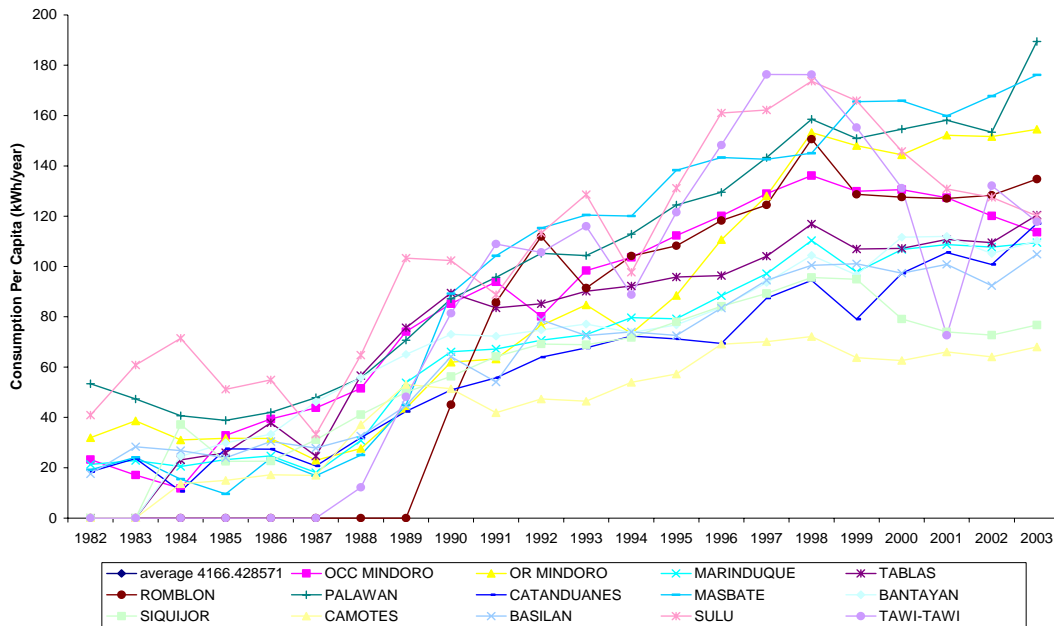
The approved rate at which the SAGR would increase over time is the Transition Index, and the time that it would take the SAGR to equal the TCGR or the NPC-SPUG True Cost of Generation, as applicable, is the Transition Period.

ERC would measure increases in development of an area by measuring growth in per-capita electricity consumption in each area. A 2002 report by the UNDP and World Bank - Rural Electrification and Development in the Philippines: Measuring the Social and Economic Benefits, reviewed the correlation between economic growth, income and electricity consumption. The study proves that greater income allows a greater nominal value to be spent on electricity. It also demonstrates that the availability of more electricity allows for greater income generation

Because tracking per capita electricity consumption in each area every year is impractical, ERC will use the historic growth in consumption per capita as the basis for forecasting growth in per capita consumption in an area.

For example, Figure 1 presents the historic per capita consumption data for fourteen NPC-SPUG Areas.

Figure 1: Improvements in Economic Development of Area



The average growth rate in consumption per capita for these fourteen areas during the period 1990 to 2003 is presented in Table 1. There are large variations among these areas.

Table 1: Average Annual Increase in Per Capita Consumption – 1990-2003

	%		
GROUP I		GROUP III	
Tablas	2.5	Palawan	6.4
Sulu	2.6	Masbate	6.9
Occidental Mindoro	2.6	Catanduanes	7.2
Camotes	2.7	Tawi-Tawi	7.2
Siquijor	2.7	Oriental Mindoro	7.9
GROUP II		Romblon	11.2
Bantayan	3.4		
Marinduque	4.4		
Basilan	4.8		

The average growth rate for all areas is 5.2%, and the standard deviation is 2.6. The average growth rate for each area could be explained by special circumstances in that area. For example, the 11.2% in Romblon is explained

by the a major increase in consumption in the early 90s driven by the commissioning of new generation facilities. For this reason ERC considers that the individual growth rates are less meaningful than the average of all areas.

The value of the Transition Index for each area could be based on the value of the average historic increase, i.e. around 5%. However, it is appropriate to assign a lower Transition Index to a group with a lower current level of development, as it would be expected that improvements in such areas would occur at a slower rate.

For example, based on the above data, ERC would classify the areas in three groups based on their level of development and would set the Transition Index at 2.5% in less developed areas, 7.5% in more developed areas, and 5% in those with average level of development.

If there are material deviations in the actual rate of economic growth in an area in relation to the Transition Index defined by ERC for that area, the EC or any other relevant government entity in the area can file a petition with the ERC, with the necessary supporting evidence, to request an adjustment of the Transition Index.

The Transition Period would be calculated as the number of years required for the SAGR to equal the TCGR or the NPC-SPUG True Cost of Generation, as applicable, if it is increased annually at the rate stipulated by the Transition Index.

It is noted that the TCGR or the NPC-SPUG True Cost of Generation, as applicable, may change over time. Periodic and automatic adjustments of the SAGR would therefore be required. The following formula would be used for calculating the SAGR in each adjustment:

$$SAGR_t = SAGR_{t-1} \times \left(\frac{TCGR_{t-1}}{TCGR_{t-2}} \right) \times (1 + T_i)^{\left(\frac{m}{12} \right)}$$

Where:

t-2 = Date of previous to last adjustment in SAGR

t-1 = Date of last adjustment in SAGR

t = Date of current adjustment in SAGR

m = Number of months in between t-1 and t

SAGR_{t-1} = SAGR applicable from t-1

SAGR_t = SAGR applicable from t

TCGR_{t-2} = TCGR between t-2 and t-1. TCGR_{t-2} is the average TCGR for the period in between t-2 and t-1, and shall be computed as total amount billed (in PhP) by the NPP or NPC-SPUG for electricity supplied during period between t-2 and t-1, divided by the volume of electricity supplied (in kWh) during the same period.

$TCGR_{t-1}$ = TCGR in between $t-1$ and t . $TCGR_{t-1}$ is the average TCGR for the period in between $t-1$ and t , shall be computed as total amount billed (in PhP) by the NPP or NPC-SPUG for electricity supplied during period between $t-1$ and t , divided by the volume of electricity supplied (in kWh) during the same period.

T_i = Transition Index

$(1 + T_i)^{(m/12)}$ would be removed from the formula when $SAGR_t$, computed using the entire formula, is greater than or equal than $TCGR_{t-1}$.

In the case of NPC-SPUG Areas, the NPC-SPUG True Cost of Generation would be used in place of the TCGR in calculating the SAGR using the above formula.

Annex II - Proposed UC-ME Administration Mechanism

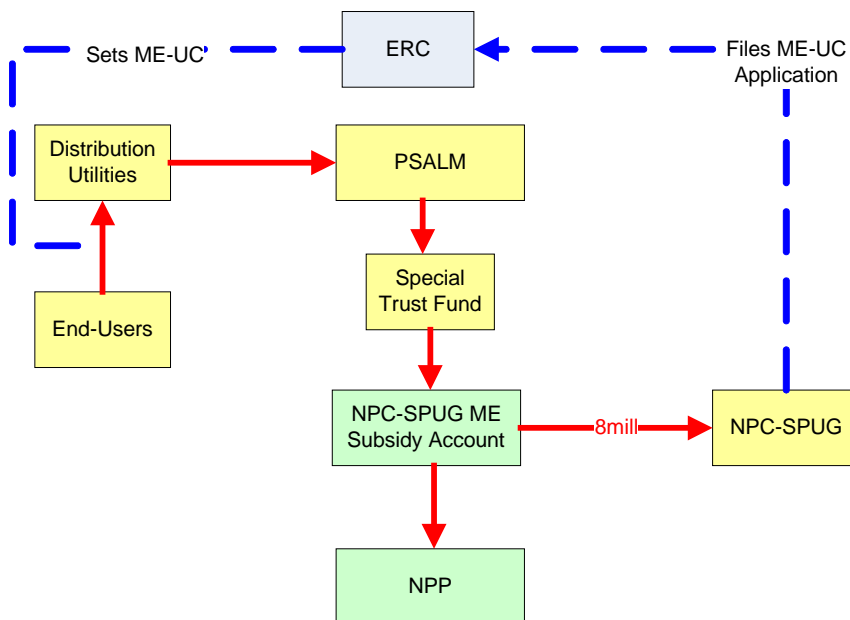
ME Subsidy payments to NPPs will represent an important portion of the total revenues to NPPs. As such, NPPs would need to have the security that ME Subsidy payments will be made on time and on the amounts determined based on the terms of the PSA.

Thus, NPPs would like appearance that payments due to them would be paid in due course and not be used to cover revenue shortfalls.

Otherwise, NPPs would expect to receive a higher return on their investment as compensation for taking on these risks. This would necessarily increase the price paid by electricity end-users in missionary areas. Because these are risks that are within the control of government, there is a need to design mechanisms to mitigate them.

To this end, NPC-SPUG shall open a trust account under NPC-SPUG's name to administer the UC-ME funds received from PSALM's STF. The account would be operated under a set of guidelines and procedures that reflect the ME Subsidy payment terms of the ERC approved PSA. The diagram below illustrates this mechanism.

Figure 2: UC-ME Administration Structure



It is suggested that subsidy obligations to NPPs are paid first, with the balance being transferred to NPC-SPUG.

Annex III - Example of Reconciliation with Actual ME Subsidy Required

Table below presents an example on how the reconciliation between the Expected and Actual ME Subsidy could be applied.

NPC-SPUG Area	SAGR (PhP/kWh)	TCGR (PhP/kWh)	ME Subsidy (PhP/kWh)	Generation Sales MWh	ME Subsidy (PhP million)
CY2005					
<i>Expected</i> Marinduque	5.6404	9.00	3.360	10,532	35.38
<i>Actual</i> Marinduque	5.6404	8.00	2.360	12,500	29.50
Over (Under) ME Subsidy Provision					5.89
CY2006					
<i>Expected</i> Marinduque	5.6404	9.00	3.360	13,000	43.67
Over (Under) ME Subsidy Provision					5.89
ME Petitioned					37.79

In this example, NPC-SPUG had filed in CY2004 for an ME Subsidy of PhP35.38 million for Marinduque for CY2005. After the competitive selection process, and the fluctuations in fuel price during CY2005, the True Cost Generation Rate for CY2005 was PhP9/kWh. During CY2005, generation sales were 12,500MWh. These changes led to an actual ME Subsidy payment of PhP29.5 million, i.e. PhP5.89 million less than expected. This over provision would be rolled into the ME Subsidy petition for Marinduque for the subsequent year, i.e. CY2006.