

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

**IN THE MATTER OF THE APPLICATION FOR
APPROVAL OF THE ANNUAL REVENUE
REQUIREMENT AND PERFORMANCE INCENTIVE
SCHEME IN ACCORDANCE WITH THE PROVISIONS
OF THE RULES FOR SETTING DISTRIBUTION
WHEELING RATES,**

ERC CASE NO. 2006– RC

MANILA ELECTRIC COMPANY

Applicant,

APPLICATION

COMES NOW, Applicant Manila Electric Company, through the undersigned counsel, and unto this Honorable Commission, most respectfully states THAT:

1. Applicant is a corporation duly organized and existing under the laws of the Philippines, with principal office at Lopez Building, MERALCO Center, Ortigas Avenue, Pasig City, where it may be served with summons and other legal processes, represented in this Application by its Vice President, Ivanna G. Dela Peña, of legal age, Filipino, married and with office address at 12th floor, Lopez Building, MERALCO Center, Ortigas Avenue, Pasig City. It is a grantee of a legislative franchise (Republic Act No. 9209) authorizing it to construct, operate and maintain a distribution system for the conveyance of electric power to the end-users in the cities/municipalities of Metro Manila, Bulacan, Cavite, Rizal and certain cities/municipalities/ barangays in Batangas, Laguna, Quezon and Pampanga.
2. Applicant has selected to enter Performance-Based Regulation at the first entry point, as described in Annex B of ERC Resolution No. 12–02 Series of 2004 dated December 10, 2004 entitled “Adopting a Methodology for Setting Distribution Wheeling Rates”, and that such selection has been approved by the Energy Regulatory Commission (ERC). This application is for the approval of the Annual Revenue Requirement and Performance Incentive Scheme required for the Second Regulatory Period described in the Guidelines on the Methodology for Setting Distribution Wheeling Rates (DWRG) issued by the ERC on

December 10, 2004 and subsequently amended by the Rules for Setting Distribution Wheeling Rates (RDWR) issued by the ERC on August 4, 2006. This Second Regulatory Period commences on July 1, 2007 and terminates on June 30, 2011.

- 2a. Applicant proposes the Annual Revenue Requirement and Performance Incentive Scheme values to form the basis of the ERC's determination of the X-factor, P₀-factor and the Maximum Annual Prices that will apply to the Applicant and on which it will base its rate setting for the Second Regulatory Period.
3. Applicant has prepared its proposal as contained in this application in accordance with the conditions described in the RDWR and in the implementing guidelines issued by the ERC in its Position Paper on the Regulatory Reset for the Second Regulatory Period, dated December 9, 2005 (Position Paper). The values in this application were arrived at using the methodology described in the RDWR, the Position Paper, and applying the financial spreadsheet model titled ERC-MODEL-FINAL-V3.3.xls (Price-Cap Model) provided by the ERC.
4. The proposed Annual Revenue Requirement is based on the Building Blocks calculation described in the RDWR, as set forth below for each Regulatory Year and for which the Applicant seeks the immediate approval of the ERC:

Table 1. Annual Revenue Requirement as per Building Block approach

Building Block	Proposed revenue requirement per Regulatory Year (PhP)			
	2008	2009	2010	2011
Operating and maintenance expenditure	17,227,403,783	19,288,866,423	21,680,182,096	24,316,372,487
Taxes, levies & duties (other than corporate tax)	886,507,866	839,330,670	804,991,287	842,081,481
Regulatory depreciation	4,922,763,886	5,072,433,354	5,389,642,180	5,685,308,576
Return on capital	17,133,127,222	18,178,151,904	19,235,504,299	20,268,517,032
Corporate income tax	3,561,274,147	4,222,848,324	5,762,874,604	8,051,793,800
TOTAL REVENUE REQUIREMENT	43,731,076,904	47,601,630,676	52,873,194,465	59,164,073,376

Note : All values are in nominal terms

The concept, meaning and application of these parameters are as described in the RDWR.

5. The Annual Revenue Requirement is based on a proposed rolled-forward value of the Applicant's Regulatory Asset Base as described below. The opening value of the Regulatory Asset Base for 2008 is based on the value of the Regulatory Asset Base on June

30, 2006, as valued by the ERC and communicated to the Applicant, suitably adjusted to a June 30, 2007 value in accordance with the method described in the RDWR.

Table 2. Summary of proposed Rolled-forward Regulatory Asset Base (RAB)

ITEM	PhP for Regulatory Year			
	2008	2009	2010	2011
Opening value of RAB	100,039,123,199	105,160,337,999	111,730,684,740	117,360,141,894
plus Capital Expenditure	10,094,542,097	11,696,656,962	11,074,691,676	11,970,992,164
minus Regulatory Depreciation on asset base at start of Second Regulatory Period	4,638,329,216	4,815,480,142	5,148,172,036	5,452,950,108
minus Regulatory Depreciation on capital expenditure incurred during the Second Regulatory Period	270,058,898	255,596,157	249,417,498	248,735,728
minus Asset Disposal	64,939,183	55,233,922	47,644,989	42,134,540
Closing value of RAB	105,160,337,999	111,730,684,740	117,360,141,894	123,587,313,681
AVERAGE VALUE OF RAB	102,599,730,599	108,445,511,370	114,545,413,317	120,473,727,787

Note : All values are in nominal terms

6. In accordance with the RDWR, the Regulatory Asset Base includes assets used beyond the standard lives, valued at 5% of their optimized replacement cost.
7. As instructed by the ERC, the Applicant has applied the preliminary values for the parameters presented below in the calculation of the Annual Revenue Requirement and Rolled-forward Regulatory Asset Base:

Table 3. Input values provided by the ERC

Parameter	Date instructed by ERC	Preliminary value adopted
Construction work in progress factor (CWIP factor)	August 29, 2006	For substation projects : 4.5% For other projects : 3.2%
P ₀ -factor		0 PhP/kWh
X-factor		-0.1040
Valuation of the Applicant's regulatory asset base as at June 30, 2006	August 28, 2006	96,640,693,811
Working-capital proportion		0%

The concept, meaning and application of these parameters are as described in the RDWR.

8. In calculating the Annual Revenue Requirement for the Second Regulatory Period, the Applicant made use of the estimated Philippine Consumer Price Index, United States of America Consumer Price Index and Philippine Peso/United States dollar exchange rate figures shown below:

Table 3a. Forecast Consumer Price Index for the Philippines

Quarter ending	2006	2007	2008	2009	2010	2011
March 31	140.4	149.4	157.6	165.9	174.6	183.8
June 30	140.0	148.9	157.2	165.4	174.1	183.2
September 30	140.4	149.3	157.6	165.8	174.5	
December 31	139.9	148.8	157.1	165.3	174.0	
Base index :		100.0		Base index year :		2000

Table 3b. Forecast Consumer Price Index for the United States of America

Quarter ending	2006	2007	2008	2009	2010	2011
March 31	198.9	206.4	211.8	216.4	221.0	225.5
June 30	202.3	207.9	213.0	217.6	222.2	226.4
September 30	203.9	209.4	214.2	218.8	223.4	
December 31	205.4	210.8	215.4	220.0	224.6	
Base index :		100.0		Base index year :		1982-1984

Table 3c. Forecast PhP/US\$ Exchange Rate

Quarter ending	2006	2007	2008	2009	2010	2011
March 31	51.18	53.74	56.43	59.25	62.21	65.32
June 30	50.54	53.06	55.72	58.50	61.43	64.50
September 30	51.41	53.98	56.68	59.51	62.49	
December 31	51.40	53.97	56.66	59.50	62.47	

- 8a. For the initial and subsequent annual price resets during the Second Regulatory Period, the Applicant will update the afore-mentioned Consumer Price Indices and foreign exchange rates with actual values in accordance with the RDWR and that such updated values will be used for the price resets.
9. The Annual Revenue Requirement is in part based on a proposed rate of return of 16.07% per annum. This rate of return corresponds with the Regulatory Weighted Average Cost of Capital which the ERC has calculated in accordance with its paper titled "Preliminary Calculation of the Regulatory Weighted Average Cost of Capital That Would Apply During the Second Regulatory Period". The ERC will determine the actual Weighted Average Cost of Capital that will apply for the setting of the Maximum Annual Prices for the Second Regulatory Period and this may differ from the rate herein proposed.
10. The proposed Capital Expenditure included in the calculation of the Rolled-forward Regulatory Asset Base are detailed below:

Table 4. Summary of proposed Capital Expenditure (per regulatory year)

ITEM	Nominal Peso				
	2007	2008	2009	2010	2011
ASSET CATEGORY					
A. Distribution Plant					

ITEM	Nominal Peso				
ASSET CATEGORY	2007	2008	2009	2010	2011
1 Land and Land Rights (Distribution Purposes)	80,345,848	151,265,238	31,523,180	35,324,810	58,288,570
2 Structures and Improvements (Distribution Purposes)	49,478,831	24,174,478	21,811,353	20,923,024	20,195,998
3 Station Equipment	0	0	0	0	0
3a Power transformers	382,387,792	374,680,233	687,729,788	661,178,598	1,032,898,813
3b Switchgear	219,958,072	129,777,278	419,760,833	418,336,571	624,242,903
3c Protective equipment	94,485,747	35,902,661	98,755,441	77,380,058	105,063,711
3d Metering & control equipment	65,460,204	7,408,847	126,200,532	94,452,018	155,795,530
3e Communications equipment	125,564,360	160,367,891	141,709,731	127,218,811	21,844,230
3f Other station equipment	150,582,014	53,647,217	343,285,014	295,085,825	615,191,296
4 Poles, Towers and Fixtures – Distribution	643,315,571	852,903,597	1,833,948,708	1,311,451,648	1,198,340,503
5 Poles, Towers and Fixtures – Customer	524,269,076	637,854,460	694,488,110	754,211,508	818,427,658
6 Overhead Conductors and Devices - Distribution	400,192,072	458,785,439	675,349,293	689,534,573	596,044,591
7 Overhead Conductors and Devices - Customer	134,152,137	75,041,701	81,704,484	88,730,766	96,285,607
8 Underground Conduits – Distribution	36,810,897	30,557,335	14,756,798	36,595,340	14,439,467
9 Underground Conduits – Customer	17,686,724	15,008,340	16,340,897	17,746,153	19,257,121
10 Underground Conductors and Devices – Distribution	26,035,017	13,653,344	3,797,324	92,806,930	90,475,259
11 Underground Conductors and Devices – Customer	10,968,526	22,512,510	24,511,345	26,619,230	28,885,682
12 Line Transformers – Distribution	397,052,720	352,677,463	451,320,123	376,981,788	434,503,318
13 Line Transformers –Customer	903,684,041	1,013,487,999	1,145,587,757	1,270,982,479	1,383,958,536
14 Power Conditioning Equipment	40,768,035	89,916,330	97,393,626	106,144,967	114,463,815
15 Services	224,112,742	256,307,177	281,927,211	303,151,806	328,062,587
16 Meters, Instruments & Metering Transformers – Distribution	804,759,717	1,141,745,310	991,169,680	915,165,581	890,088,756
17 Meters, Instruments & Metering Transformers – Customer	829,599,961	753,460,363	808,865,847	878,998,846	953,070,667
18 Information Technology Equipment (distribution)	273,275,270	704,845,462	404,802,524	620,295,206	410,584,036
19 Regulated Entity Property on Consumer's Premises	134,171,758	129,620,705	141,129,433	153,266,040	166,315,636
20 Street Lights and Signal Systems	157,091,541	165,374,346	177,584,526	190,334,385	202,819,702
21 Submarine Cables	0	0	0	0	0
SUB-TOTAL Distribution Plant	6,726,208,672	7,650,975,726	9,715,453,559	9,562,916,960	10,379,543,991
B. General Plant					
1 Land and Land Rights (non-network)	0	0	0	0	0
2 Structures and Improvements (non-network)					

ITEM	Nominal Peso				
ASSET CATEGORY	2007	2008	2009	2010	2011
	126,071,109	72,747,831	90,428,138	37,267,919	26,420,685
3 Office Furniture and Equipment	30,708,622	26,100,420	28,889,406	26,520,130	40,144,655
4 Transportation Equipment	333,941,827	292,248,411	324,479,181	292,088,066	294,630,708
5 Stores Equipment	0	0	0	0	0
6 Tools, Shop and Garage Equipment	133,299,820	130,798,972	46,573,207	24,867,893	51,877,192
7 Laboratory Equipment	102,961,998	59,889,067	50,974,527	46,755,683	69,040,729
8 Information Systems Equipment (non-network)	384,624,467	393,201,645	293,267,992	217,611,310	221,403,217
9 Power-operated Equipment	0	0	0	0	0
10 Communication Plant and Equipment	23,225,732	36,483,223	54,596,276	57,342,368	43,249,417
11 Miscellaneous Equipment	15,569,300	7,743,043	6,275,800	5,525,904	4,350,776
SUB-TOTAL General Plant	1,150,402,875	1,019,212,613	895,484,528	707,979,273	751,117,379
C. Materials and Supplies (including spares)	194,856,838	113,571,606	16,713,823	17,950,488	19,270,894
D. Transferred Subtransmission Assets	74,370,180	719,661,192	218,070,295	0	0
E. Allocated Overheads Capitalized	291,614,875	591,120,960	850,934,758	785,844,956	821,059,899
TOTAL CAPITAL EXPENDITURE	8,437,453,441	10,094,542,097	11,696,656,962	11,074,691,676	11,970,992,164

10a. The proposed Capital Expenditures are necessary to meet expected increases in peak demand following increases in customer count and energy consumption in Applicant's franchise area; to replace and refurbish aging, obsolete, and overloaded facilities; and to comply with regulatory requirements as embodied in the EPIRA (RA9136), the Grid and Distribution Codes, and other relevant rules and regulations. The significant increases from historical CAPEX levels reflect the catch up that is being undertaken to cover prior years' under-investments. Following the refund of 16.7 centavos per kwh ordered by the Supreme Court, G.R. Nos. – 141314 and 141369, Applicant curtailed its expenditures starting 2002 under a Comprehensive Liability Management Plan, a component of which was the refinancing of its loans by its creditors. The refinancing undertaken by Applicant in 2004 extended the payment terms of its loans but imposed caps both on its CAPEX and operating and maintenance expenditures (OPEX). Given the scaling down undertaken in the past, Applicant has to raise its CAPEX to levels appropriate to maintain the integrity of the electric

system while providing additional distribution capacity to meet the demand of existing and future customers.

11. The proposed Operating & Maintenance Expenditures included in the calculation of the Annual Revenue Requirement are presented below:

Table 5. Summary of proposed Operating & Maintenance Expenditure (per regulatory year)

Opex Category and Sub-category	Nominal Php				
	2007	2008	2009	2010	2011
Distribution : Operation					
Operations, Supervision & Engineering	338,280,690	395,776,529	458,656,021	531,427,523	616,581,762
Load Dispatching	119,388,883	122,138,891	140,948,689	161,889,784	185,173,332
Substation	84,556,559	93,015,141	103,124,401	114,261,409	126,138,743
Overhead Line – demand	174,772,432	196,799,395	221,082,488	248,326,509	279,118,165
Overhead Line – customer	-	-	-	-	-
Streetlighting (non-roadway)	-	-	-	-	-
Streetlighting (roadway)	95,249,079	111,545,047	121,497,332	132,751,711	146,534,372
Metering	78,220,407	1,918,229,713	2,065,793,836	2,220,242,783	2,385,629,893
Consumer Installation Expenses	202,727,649	227,737,561	255,108,875	285,492,396	319,650,616
Rents	7,574,061	8,651,269	10,028,539	11,606,693	13,435,879
Information Technology	130,845,348	140,868,158	187,552,767	222,174,760	277,486,220
Miscellaneous Expenses	203,683,515	228,364,570	255,217,000	285,370,745	319,716,859
Distribution : Maintenance	-	-	-	-	-
Maintenance, Supervision & Engineering	496,079,914	576,618,766	664,677,129	766,220,825	884,668,377
Structures	21,413,013	23,541,009	25,882,168	28,471,142	31,343,786
Substation	213,189,186	241,263,312	269,998,578	300,986,819	334,049,331
Overhead Line – demand	1,040,642,186	1,171,816,132	1,315,727,948	1,476,573,406	1,657,933,957
Overhead Line – customer	-	-	-	-	-
Streetlighting (non-roadway)	-	-	-	-	-
Streetlighting (roadway)	20,446,514	21,179,758	21,928,562	24,621,567	27,661,555
Line Transformers	70,704,446	79,867,319	89,945,424	101,229,843	113,972,076
Information Technology	52,621,348	68,783,210	83,129,512	99,709,913	115,249,829
Metering	407,439,825	459,640,530	517,072,931	581,138,283	653,402,993
Miscellaneous Plant	166,739,872	181,234,531	195,868,450	211,113,899	226,904,879

Opex Category and Sub-category	Nominal Php				
	2007	2008	2009	2010	2011
Sub-total Distribution	3,924,574,926	6,267,070,842	7,003,240,653	7,803,610,009	8,714,652,626
Consumer Accounts					
Supervision	318,585,654	355,003,339	393,919,935	437,821,893	488,302,218
Meter Reading	242,486,670	271,716,506	303,406,408	338,543,312	378,050,156
Information Technology	319,895,674	342,402,166	372,671,385	392,357,612	412,062,877
Customer Records & Collection Expenses	2,135,827,746	2,392,292,376	2,669,468,195	2,976,617,052	3,321,975,430
Uncollectible Accounts	495,475,815	586,219,710	710,171,880	873,875,985	1,052,257,803
Informational and Instructional Advertising	101,519,460	114,995,271	132,327,868	156,616,539	190,460,787
Miscellaneous	107,168,603	126,105,923	147,071,769	171,275,144	199,462,277
Consumer Prompt Payment Discount	-	-	-	-	-
Sub-total Consumer Accounts	3,720,959,622	4,188,735,291	4,729,037,439	5,347,107,537	6,042,571,549
Administrative & General Expenses					
Administrative and General Salaries	633,303,435	746,267,982	873,680,415	1,021,603,176	1,194,925,682
Office Supplies & Expenses	79,766,203	86,353,712	92,973,668	99,892,837	107,293,552
Information Technology	314,234,430	357,068,492	404,685,923	454,112,768	499,501,062
Outside Services Employed	207,099,397	224,202,744	241,390,335	259,354,783	278,569,483
Property Insurance	111,119,936	120,802,719	130,538,960	141,031,823	152,606,474
Injuries & Damages	39,519,259	44,072,024	48,974,417	54,468,854	60,723,223
Employee Pension & Benefits	1,398,145,868	1,630,240,433	1,891,991,565	2,194,060,146	2,545,468,606
Rents	10,706,877	12,594,837	14,602,530	16,903,220	19,569,990
Maintenance of Office & General Plant	314,026,340	341,349,740	369,930,515	400,695,462	434,742,328
Officers Allowances and Benefits	5,575,195	6,480,221	6,830,189	7,187,558	7,565,016
Travel	61,390,842	66,460,817	71,555,765	76,880,999	82,576,846
Training	107,091,766	147,530,635	162,652,249	177,657,238	200,435,629
Bad Debts	-	-	-	-	-
Regulatory Liaison & Compliance	249,512,330	279,516,079	311,524,830	405,572,444	449,178,619
Foreign Exchange Losses or Gains	-	-	-	-	-
Others	214,578,709	232,299,736	250,108,051	268,721,278	288,629,908
Sub-total Administrative & General	3,746,070,587	4,295,240,171	4,871,439,413	5,578,142,585	6,321,786,419
WESM Compliance	-	-	-	-	-
Registration Fees	121,117	128,297	135,226	142,301	149,774
Metering Fees					

Opex Category and Sub-category	Nominal Php				
	2007	2008	2009	2010	2011
	8,574,085	9,082,365	9,572,864	10,073,735	10,602,761
Billing & Settlement Fees	149,798,207	217,230,496	238,524,662	261,897,451	287,653,413
Administration Fees	12,092,084	14,300,816	16,744,567	19,585,096	22,915,447
Cost for the PEM Board, Committees & Working Groups	531,216	562,707	593,096	624,128	656,904
Market Management Software & Upgrades	1,062,431	3,938,946	5,930,959	6,241,278	6,569,041
Provision of Security (Prudential Requirement)	1,170,553,273	1,684,847,532	1,827,916,583	2,003,526,815	2,196,915,594
Others	504,388,846	546,266,321	585,730,963	649,231,160	711,898,958
Sub-total WESM Compliance	1,847,121,259	2,476,357,480	2,685,148,918	2,951,321,965	3,237,361,893
Total Operating & Maintenance Expenditure	13,238,726,394	17,227,403,783	19,288,866,423	21,680,182,096	24,316,372,487

11a. The proposed operating and maintenance expenditures are necessary to: (i) maintain the safety, efficiency and reliability of the distribution network, (ii) support the growing asset base, (iii) allow Applicant to deliver services to its customers and support its business operations, (iv) perform additional functions brought about by regulatory changes, and (v) meet the performance targets under the Performance Incentive Scheme. Applicant's historical operating and maintenance expenditures were low because of the caps imposed by the lenders in exchange for the refinancing of its loans. Nonetheless, such stringent caps or limits on operating and maintenance expenditures can no longer be maintained and that there is a need to increase the expenditures to appropriate levels to best serve the long-term interests of its customers.

12. The proposed expenditures on Taxes, Levies and Duties (other than corporate income tax) included in the calculation of the Annual Revenue Requirement is illustrated below:

Table 6. Summary of proposed Taxes, Levies & Duties (other than corporate income tax) expenditure (per Regulatory Year)

	Nominal PhP				
	2007	2008	2009	2010	2011
Taxes, levies & duties (nominal PhP)	264,428,548	886,507,866	839,330,670	804,991,287	842,081,481

12a. The proposed taxes, levies and duties (other than corporate income taxes) expenditures show a marked increase from current levels due to new and additional impositions initiated

by various Local Government Units (LGUs) within the franchise area such as impositions of real property taxes on poles, wires, insulators, transformers, etc.; revision of existing assessed values of real properties; and changes in the schedules of regulatory fees and other permits.

13. The proposed Depreciation included in the calculation of the Annual Revenue Requirement include depreciation on the Applicant's Regulatory Asset Base as of the start of the Second Regulatory Period, as well as depreciation on assets that will be added to the asset base during the Second Regulatory Period.

Table 7. Summary of proposed Depreciation (per Regulatory Year)

ITEM	2007	2008	2009	2010	2011
A. Distribution Plant					
Land and Land Rights	0	0	0	0	0
Structures and Improvements	22,023,310	22,943,977	22,012,439	22,521,281	22,942,135
Station Equipment	0	0	0	0	0
Power transformers	190,995,740	199,407,607	202,141,993	212,925,873	230,756,387
Switchgear	294,498,687	279,129,385	265,902,901	277,389,855	292,297,650
Protective equipment	56,383,965	54,156,840	51,645,269	53,530,799	55,648,751
Metering and control equipment	23,575,281	24,283,314	26,003,686	29,467,299	33,418,538
Communications Equipment	443,555,119	392,162,414	407,567,052	360,939,526	295,710,537
Other Station Equipment	76,112,718	75,873,266	78,623,955	88,387,644	102,401,115
Poles, Towers and Fixtures - Distribution	651,184,300	552,793,564	568,694,907	586,292,149	595,079,983
Poles, Towers and Fixtures - Customer	5,518,622	17,751,501	31,776,160	47,025,629	63,579,726
Overhead Conductors and Devices - Distribution	312,677,548	320,659,301	323,387,224	341,271,878	358,065,739
Overhead Conductors and Devices - Customer	1,916,459	4,904,943	7,144,174	9,578,963	12,222,054
Underground Conduits - Distribution	4,836,365	5,678,044	6,226,301	6,867,647	7,506,880
Underground Conduits - Customer	221,084	629,772	1,021,638	1,447,726	1,910,267
Underground Conductors and Devices - Distribution	23,243,113	23,796,260	24,004,069	25,384,129	28,002,446
Underground Conductors and Devices - Customer	156,693	634,994	1,306,763	2,037,200	2,830,127
Line Transformers - Distribution	843,277,153	823,318,392	796,844,276	794,464,045	791,392,428
Line Transformers - Customers	15,061,401	47,014,268	82,998,864	123,275,035	167,524,051
Power Conditioning Equipment	51,730,230	49,476,221	39,789,290	42,696,984	45,848,538
Services	429,964,827	400,454,279	370,444,835	374,808,224	379,276,097
Meters, Instruments & Metering Transformers - Distribution	639,566,682	675,211,726	715,463,355	751,588,146	782,679,538
Meters, Instruments & Metering Transformers - Customer	16,591,999	48,253,206	79,499,730	113,257,024	149,898,414
Information Technology Equipment	73,923,534	87,417,834	131,623,338	192,857,228	262,738,560
Regulated Entity Property on Consumers' Premises	107,546,564	100,665,688	91,845,334	93,520,554	95,723,814
Street Lights and Signal Systems	101,524,484	81,974,432	62,433,128	67,868,970	73,599,072
Submarine Cables	0	0	0	0	0
Subtotal Distribution Plant	4,386,085,880	4,288,591,229	4,388,400,679	4,619,403,807	4,851,052,849

ITEM	2007	2008	2009	2010	2011
B. General Plant					
Land and Land Rights (non-network)	0	0	0	0	0
Structures and Improvements (non-network)	115,983,064	118,468,301	75,254,875	76,847,214	68,710,285
Office Furniture and Equipment	9,323,377	6,347,092	8,608,786	10,321,485	13,489,484
Transportation Equipment	32,361,962	60,934,443	95,401,108	130,807,084	164,183,145
Stores Equipment	3,100,890	2,282,842	2,205,110	2,159,510	2,132,307
Tools, Shop and Garage Equipment	29,445,286	31,938,602	35,969,630	37,142,048	37,714,763
Laboratory Equipment	27,447,275	29,999,987	32,450,833	34,396,351	36,704,674
Information Systems Equipment	232,722,176	188,860,699	219,179,680	253,808,997	280,012,587
Power-operated Equipment	50,595,705	49,249,613	48,804,620	48,556,581	46,499,732
Communication Plant and Equipment	75,334,234	62,840,848	62,672,448	54,834,924	44,990,366
Miscellaneous Equipment	20,849,143	13,042,073	12,653,255	12,556,597	12,658,960
Subtotal General Plant	597,163,110	563,964,499	593,200,346	661,430,791	707,096,303
C. Materials and Supplies (including spares)	0	0	0	0	0
D. Transferred subtransmission assets	3,558,382	36,259,874	45,868,501	45,868,501	45,868,501
E. Allocated Overheads Capitalized	4,860,248	19,572,512	43,606,774	70,886,436	97,668,183
F. Asset Disposal	0	0	0	0	0
Total Asset Value	4,991,667,620	4,908,388,114	5,071,076,299	5,397,589,534	5,701,685,836

13a. The depreciation is calculated on a straight–line basis, based on the standard asset lives approved by the ERC.

14. The proposed Corporate Income Tax included in the calculation of the Annual Revenue Requirement is based on a Philippine corporate tax rate of 35% as shown below:

Table 8. Summary of proposed Corporate Income Tax (per Regulatory Year)

	2008	2009	2010	2011
Corporate Tax (nominal PhP)	3,561,274,147	4,222,848,324	5,762,874,604	8,051,793,800

15. The calculation of the foregoing proposed Corporate Income Tax is based on the forecast sales of energy within the Applicant’s franchise area as shown below:

Table 9. Summary of forecast energy consumption (per Regulatory Year)

	2007	2008	2009	2010	2011
Energy consumption (MWh)	26,051,615	26,595,237	27,230,171	28,501,206	29,692,974

16. The calculation of the Corporate Income Tax is based on an estimated price–path for the Second Regulatory Period that was determined using the proposed Allowed Annual

Revenues and an assumed zero P_0 -factor. The estimated Maximum Annual Prices thus calculated for the Second Regulatory Period are shown below:

Table 10. Assumed Maximum Annual Prices for the Second Regulatory Period

	2008 Regulatory year	2009 Regulatory year	2010 Regulatory year	2011 Regulatory year
Maximum Annual Price (PhP/kWh)	1.4579	1.6895	1.9534	2.2593

- 16a. Under the RDWR, the ERC will determine the actual X-factor and P_0 -factor after its consideration of this application for Allowed Annual Revenue Requirement and will determine the actual price-path for the Second Regulatory Period after incorporating such amendments to these proposals as the ERC deems necessary. As part of its consideration, the ERC may also amend one or more of the parameters on which the calculations of the Allowed Annual Revenue Requirement are based. The actual approved price path may differ from that estimated above.
17. The Maximum Average Prices calculated under Performance-Based Regulation are not directly comparable with the unbundled rates. For illustrative purposes, the Applicant has prepared a comparison of its current rates for providing distribution wheeling and related services with those that would result from the implementation of the estimated Maximum Annual Prices. This comparison is presented below:

Table 11. Comparison of estimated rates with current rates (illustrative only)

	Current Rates	Normalized Rates	Illustrative Rates (2008)	Illustrative Rates (2009)	Illustrative Rates (2010)	Illustrative Rates (2011)
AVERAGE PhP/kWh DISTRIBUTION RATE						
Residential&General Service	1.9110	2.0586	2.2654	2.4970	2.7609	3.0668
Non-Industrial Service	0.5431	0.7170	0.9238	1.1554	1.4193	1.7252
Industrial	0.3452	0.4799	0.6867	0.9183	1.1822	1.4881
Government Hospitals & Metered Streetlights	0.6207	0.7719	0.9787	1.2103	1.4742	1.7801
Flat Streetlights	2.5587	2.6700	2.8768	3.1084	3.3723	3.6782

Notes:

1. Average distribution rate includes distribution wheeling, supply and metering.
2. Normalized rates reflect the impact of Meralco's Petition filed on May 31, 2005 which is still pending at ERC.
3. For every year of the Second Regulatory Period, the adjustments are reflected across-the-board for all customer classes.

18. The Applicant proposes to adopt a Price-Linked Performance Incentive Scheme, as required by the RDWR. According to this Performance Incentive Scheme, the Applicant will be rewarded if the service performance levels of its electricity distribution business exceed the target levels proposed below, and will be penalized if the service performance levels of its electricity distribution business fall below the proposed targets. This reward or penalty will be directly incorporated into the Maximum Annual Prices starting from the second year of the Second Regulatory Period. The proposed Price-linked Performance Incentive Scheme is based on the performance measures and performance targets shown below. Graduated performance target levels are proposed which would influence the size of the reward or penalty.

Table 12. Summary of proposed Price-linked Performance Incentive Scheme

Performance Index	Units	Weight	Reward		Target	Penalty	
			Level 5	Level 4	Level 3	Level 2	Level 1
1. Interruption Frequency Rate (IFR) – Forced and Pre-arranged	Number	0.20	Does not Exist	IFR is greater than 0 but less than 3.59	IFR is greater than or equal to 3.59 but less than or equal to 20.02	IFR is greater than 20.02 but less than or equal to 28.24	IFR is greater than 28.24
2. Cumulative Interruption Time (CIT)- Forced only	Hours	0.20	Does not Exist	Forced CIT is greater than 0 but less than 2.63	Forced CIT is greater than or equal to 2.63 but less than or equal to 11.47	Forced CIT is greater than 11.47 but less than or equal to 15.88	Forced CIT is greater than 15.88
3. Cumulative Interruption Time (CIT)– Pre-arranged only	Hours	0.15	Does not Exist	Pre-arranged CIT is greater than 0 but less than 1.02	Pre-arranged CIT is greater than or equal to 1.02 but less than or equal to 8.62	Pre-arranged CIT is greater than 8.62 but less than or equal to 12.42	Pre-arranged CIT is greater than 12.42
4. Voltage Regulation Index: Probability of Voltage Violation (pVv)	%	0.10	pVv is less than or equal to 2%	pVv is less than 3% but greater than 2%	pVv is greater than or equal to 3% but less than or equal to 5%	pVv is greater than 5% but less than 6%	pVv is greater than or equal to 6%
5. System Loss (Current)	%	0.05	System loss is less than or equal to 9.84%	System loss is less than 10.55% but greater than 9.84%	System loss is greater than or equal to 10.55%	Not Applicable	Not Applicable
6. Time to Process Applications (TPA)	Days	0.10	TPA is less than 4 days	TPA is greater than or equal to 4 days but less than 7 days	TPA is greater than or equal to 7 days but less than 19 days	TPA is greater than or equal to 19 days but less than 22 days	TPA is greater than or equal to 22 days
7. Time to Connect Premises (TCP)	Days	0.10	TCP is less than 1 day	TCP is greater than or equal to 1 day but less than 2 days	TCP is greater than or equal to 2 days but less than 4 days	TCP is greater than or equal to 4 days but less than 7 days	TCP is greater than or equal to 7 days
8. Call Center Performance (CCP)	%	0.10	CCP is less than 6.23%	CCP is greater than or equal to 6.23% but less than 12.66%	CCP is greater than or equal to 12.66% but less than 25.50%	CCP is greater than or equal to 25.50% but less than 31.93%	CCP is greater than or equal to 31.93%

19. The Applicant proposes to adopt a Guaranteed Service Level Incentive Scheme as required by the RDWR. According to this Guaranteed Service Level scheme, customers will be directly compensated in the form of reductions in their monthly electricity bills if service performance falls below certain minimum thresholds. The thresholds and the penalties that will apply are shown below:

Table 13. Summary of proposed Guaranteed Service Level Incentive Scheme

Performance Measure	Threshold	Penalty level (PhP)
Customer experiencing a total duration of sustained service interruptions in a Regulatory Year that exceeds the threshold	20 Hours	47.00
Customer experiencing a number of sustained service interruptions in a Regulatory Year that exceeds the threshold	20 Times	211.73
Restoration of supply to a customer after a fault on the secondary distribution network taking longer than the threshold time	12 Hours	73.28
Customer connection not provided on the day agreed with the customer	0 days	74.75

- 19a. The Applicant will be entitled to an additional revenue amount equal to 0.5% of its Annual Revenue Requirement. This is intended to be applied to the Guaranteed Service Level Incentive Scheme and can be used either to fund the penalties under the scheme, or for network and/or operational improvements to avoid such penalties.
20. In addition to the foregoing, Applicant likewise proposes the inclusion in the Regulatory Asset Base of facilities within the Meralco Center aimed primarily at promoting and ensuring the health and general well-being of Meralco employees. These facilities are recognized by law as necessary to enable a public utility to provide competent and efficient service and are valued at PhP364,627,903.
21. In support of this application for the approval of its Allowed Annual Revenue and Performance Incentive Scheme, the Applicant has attached the following required documents as described in the RDWR and the Position Paper:

Table 14. Supporting Information attached

Schedule	Information provided
A	Regulatory Asset Base
A1	Summary of the optimized depreciated replacement cost (ODRC) and the depreciated historical cost of the Regulatory Asset Base as at the initial valuation date (the Regulatory Asset Base).
A2	Summary of the optimized depreciated replacement cost and the depreciated historical cost of the Original Regulatory Asset Base as at the start of the Second Regulatory Period, with supporting calculations for indexing applied.
A3	Assets forecast to be acquired during the period between the initial valuation date and the start of the Second Regulatory Period.
A3.1	- Schedule of assets to be acquired
A3.2	- Value of the assets to be acquired
A3.3	- Justification for assets to be acquired
A5	Forecast asset disposal during the period between the initial valuation date and the start of the Second Regulatory Period.
A5.1	- Schedule of assets to be disposed of
A5.2	- Value of the assets to be disposed of
A5.3	- Forecast income from the sale of disposed assets
A6	ODRC depreciation schedules for the Regulatory Asset Base for the period between the initial valuation date and the start of the Second Regulatory Period.
A6.1	- Assets included in the Original Regulatory Asset Base
A6.2	- Assets acquired in the lead-up to the Second Regulatory Period
A7	Historical cost depreciation schedules for the Regulatory Asset Base for the period between the initial valuation date and the start of the Second Regulatory Period.
A7.1	- Assets included in the Original Regulatory Asset Base
A7.2	- Assets acquired in the lead-up to the Second Regulatory Period
A8	Application of the construction work in progress (CWIP) factor to the Regulatory Asset Base as at the start of the Second Regulatory Period.
A9	Summary of the optimized depreciated replacement cost (ODRC) and the depreciated historical cost of the full Regulatory Asset Base as at the start of the Second Regulatory Period (the opening value of the rolled-forward Regulatory Asset Base).
A10	Justification for inclusion in the Regulatory Asset Base of certain facilities within the Meralco Center
B	Financial indices forecast for Second Regulatory Period
B1	Philippine quarterly CPI
B2	United States quarterly CPI
B3	PhP/US\$ quarterly exchange rate
B4	180-Day Manila Reference Rate
C	Forecast capital expenditure for the Second Regulatory Period

Schedule	Information provided
C1	Summary of capital expenditure forecasts for each year of the Second Regulatory Period
C1.1	- Real values, divided in PhP and US\$ components
C1.2	- Nominal values, divided in PhP and US\$ components
C1.3	- Total nominal values, in PhP
C1.4	- Justification for capital expenditure (major and minor projects)
C2	Broken down historical capital expenditure
D	Forecast disposals during the Second Regulatory Period
D1	Value of assets to be disposed of (based on ODRC register)
D2	Forecast income from the sale of disposed assets
E	Forecast depreciation during the Second Regulatory Period
E1	Depreciation of the opening asset base
E1.1	- ODRC basis
E1.2	- Historical cost basis
E2	Depreciation of the assets forecast to be acquired during the Second Regulatory Period
E2.1	- ODRC basis
E2.2	- Historical cost basis
F	Forecast assets used beyond standard lives
F1	Forecast addition to assets used beyond standard lives
F2	Forecast removal from assets used beyond standard lives
G	Forecast operating & maintenance expenditure
G1	Summary of forecast operating & maintenance expenditure
G1.1	- Annual expenditure, divided in real PhP and US\$ components
G1.2	- Annual expenditure, divided in nominal PhP and US\$ components
G1.3	- Total annual expenditure, in nominal PhP
G1.4	- Justification for operating & maintenance expenditure forecasts
G2	Historical operating & maintenance expenditure
G3	Summary of expenditure on taxes (other than corporate income tax), duties and levies
G3.1	- Annual expenditure, in real PhP
G3.2	- Annual expenditure, in nominal PhP
G3.3	- Justification for expenditure
G3.4	- Historical taxes, levies & duties
H	Forecast energy consumption and demand
H1	Forecast energy consumption figures (kWh)
H1.1	- Breakdown of consumption figures
H1.2	- Supporting evidence
H2	Forecast energy demand figures (kW)
H2.1	- Breakdown of demand figures
H2.2	- Supporting evidence
I	Regulatory financial statements

Schedule	Information provided
J	Performance incentive scheme details
J1	Price-linked incentive scheme
J1.1	- Details of scheme proposed
J1.2	- Proposed target levels
J1.3	- Supporting information & calculations
J2	Guaranteed service level scheme
J2.1	- Details of scheme proposed
J2.2	- Proposed target levels
J2.3	- Proposed penalty levels
J2.4	- Supporting information & calculations
K	Calculation of Weighted Average Cost of Capital
L	Additional information for price-cap model
L1	Contact details for input sheets
L2	2006 Billing & consumption data
L3	Related business revenue for 2006
L4	Maximum annual price for 2006 and 2007 (initial entrants)
L5	Tax losses carried forward from 2007 regulatory year
M	Detailed calculations for Second Regulatory Period
	Rolled forward regulatory asset base
	Annual revenue requirement
	Corporate income tax forecasts
	Forecast price-caps for the opening and subsequent years of the Second Regulatory Period
N	Calculation of demonstrative unbundled rates

22. Applicant has complied with the requirements of Section 4(e), Rule 3 of the Rules and Regulations of Republic Act No. 9136, in relation to Rule 6 of the ERC Rules of Practice and Procedure, prior to the filing of this application with the ERC. Attached herewith are: (i) Letter dated September 1, 2006 to the Sangguniang Panglungsod of Pasig City as Schedule "O" (ii) Acknowledgment dated September 1, 2006 issued by the Sangguniang Panglungsod of Pasig City as Schedule "P" (iii) Affidavit of Publication dated September 1, 2006 executed by Luzviminda Bugaoisan of Malaya as Schedule "Q" and (iv) issue of Malaya dated September 1, 2006, as Schedule "R".
23. Applicant most respectfully requests for approval of this application to allow it to fulfill its obligations under Performance Based-Regulation and in order to avoid irreparable losses

which will ultimately result in the deterioration of its services, to the damage and prejudice of the public, in general, and its consumers, in particular.

PRAYER

WHEREFORE, premises considered, Applicant Manila Electric Company most respectfully prays to this Honorable Commission, that this application be approved and the Applicant be authorized to adopt the Annual Revenue Requirements and Performance Incentive Scheme as proposed herein.

Other reliefs equitable under the premises are likewise prayed for.

Pasig City, Philippines, 31 August 2006.

RAUL G. CORALDE

JOSE RONALD V. VALLES

ROMMEL L. YAP

MARIA ZARAH R. VILLANUEVA-CASTRO

CORNELIO MANUEL C. DICCION

MICHELLE O. DELOS SANTOS-BONA

Counsel for Applicant

8th Floor, Lopez Building,

Ortigas Ave., Pasig City

By:

RAUL G. CORALDE

PTR No. 2941529, 1/2/06

IBP No. 663844, 12/28/05

ROLL OF ATTY. 35522

MCLE Compliance No. I-0009490

JOSE RONALD V. VALLES

PTR No. 2941527, 1/2/06

IBP No. 663842, 12/28/05

ROLL OF ATTY. 42281

MCLE Compliance No. I-0010894

ROMMEL L. YAP

PTR No. 2941528, 1/2/06

IBP No. 663833, 12/28/05

ROLL OF ATTY. 43007

MCLE Compliance No. I-0002568

MARIA ZARAH R. VILLANUEVA-CASTRO

PTR No. 2941504, 1/2/06

IBP No. 663820, 12/28/05

ROLL OF ATTY. 42053

MCLE Compliance No. I-0009500

CORNELIO MANUEL C. DICCION III

PTR No. 2941522, 1/2/06

IBP No. 663838, 12/28/05

ROLL OF ATTY. 45053

MCLE Compliance No. I-0004711

MICHELLE O. DELOS SANTOS-BONA

PTR No. 2941521, 1/2/06

IBP No. 663837, 12/28/05

ROLL OF ATTY. 47284

MCLE Compliance No. I- 0002602

VERIFICATION

I, **IVANNA G. DELA PENA**, of legal age, with office address at 12th floor, Lopez Building, Ortigas Ave., Pasig City, after being sworn to, hereby depose and say, that—

1. I am the Vice President and Head, Utility Economics of Applicant Manila Electric Company;
2. I have been authorized by the Board of Directors of Applicant to cause the preparation and filing of the instant Application. Attached as Schedule “S” is a Secretary’s Certificate authorizing the undersigned to represent Applicant in this Application and to sign this Verification.
3. I have read and understood the allegations contained herein and the same are true and correct based on my personal knowledge and authentic records of the company.

IN WITNESS WHEREOF, I have hereunto set my hand this 31st day of August 2006 at Pasig City, Philippines.

IVANNA G. DELA PENA

SUBSCRIBED AND SWORN TO before me this 31st day of August 2006 at Pasig City, Philippines, Affiant exhibiting to me her Community Tax Certificate No. 08116192, issued at Pasig City on January 5, 2006.

Doc. No: _____;
Page No. _____;
Book No. _____;
Series of 2006.

CERTIFICATE OF NON-FORUM SHOPPING

I, **GIL S. SAN DIEGO**, of legal age, with office address at 8th Floor, Lopez Building, Ortigas Ave., Pasig City, after being sworn to, depose and say, that—

1. I am the Vice President and Head, Legal Services of Applicant Manila Electric Company;
2. I have been authorized by the Board of Directors (Schedule "S") to certify that Applicant has not commenced any other action or proceeding involving the same issues in the Supreme Court, the Court of Appeals or any court, tribunal or agency, and to the best of my knowledge, no such other action or claim is pending therein; and
3. If I should hereinafter learn that the same or a similar action or claim has been filed or is pending in the Supreme Court, the Court of Appeals or any court, tribunal or agency, I undertake to report said fact within five (5) days from discovery thereof to the Honorable Commission.

IN WITNESS WHEREOF, I have hereunto set my hand this 31st day of August 2006 at Pasig City, Philippines.

GIL S. SAN DIEGO

SUBSCRIBED AND SWORN TO before me this 31st day of August 2006 at Pasig City, Philippines, affiant exhibiting to me his Community Tax Certificate No. 12521909 issued at Quezon City on January 4, 2006.

Doc. No: _____;
Page No. _____;
Book No. _____;
Series of 2006.