



**Performance Based Regulation  
of  
Privately Owned Electricity Distribution Utilities**

**Discussion Paper on Modifications to  
the Rules for Setting Distribution  
Wheeling Rates (RDWR)**

**September 26, 2008**

**Republic of the Philippines  
Energy Regulatory Commission  
Pacific Center, San Miguel Avenue, Pasig City**

# **Performance Based Regulation of Privately Owned Electricity Distribution Utilities**

## **Discussion Paper on Modifications to the Rules for Setting Distribution Wheeling Rates (RDWR)**

Pursuant to Section 43(f) of Republic Act No. 9136, otherwise known as the Electric Power Industry Reform Act of 2001, and Rule 15, Section 5(a) of the Implementing Rules and Regulations issued pursuant to that Act, the Energy Regulatory Commission (ERC) promulgated the Distribution Wheeling Rates Guidelines (DWRG) under ERC Resolution No 12-02, Series of 2004, dated December 10, 2004. The DWRG has subsequently been revised and re-issued as the Rules for Setting Distribution Wheeling Rates for Privately-Owned Distribution Utilities Entering Performance Based Regulation [Second and Later Entry Points] [ERC Resolution No. 54, Series of 2006, dated December 13, 2006, hereafter referred to as the 'RDWR'].

In terms of Section 1.9 of the RDWR, these rules may from time to time be changed by the ERC. The ERC has determined that several changes are now required to the RDWR, as described in this Discussion Paper. Submissions from interested parties are sought on the proposed changes described in the Discussion Paper. Interested parties are also invited to suggest further changes to the RDWR, for consideration by the ERC. Details of the required format and time of submissions are provided in Section 1.4 of the paper.

**Performance Based Regulation of  
Privately Owned Electricity Distribution Utilities**

**Discussion Paper on Modifications to the Rules  
for Setting Distribution Wheeling Rates (RDWR)**

**TABLE OF CONTENTS**

<b>1.</b>	<b>INTRODUCTION.....</b>	<b>4</b>
1.1	Purpose.....	4
1.2	Use of terms and definitions in the Discussion Paper.....	5
1.3	Outline of this paper.....	5
1.4	Submissions on the Discussion Paper.....	5
1.5	Process going forward .....	6
1.6	Retrospective effect of the changes.....	6
<b>2.</b>	<b>GENERAL CHANGES TO THE RDWR .....</b>	<b>7</b>
2.1	Proposed general changes .....	7
<b>3.</b>	<b>SPECIFIC CHANGES.....</b>	<b>9</b>
3.1	Definition Changes.....	9
3.2	Provision of Information .....	12
3.3	Rate-setting during the Second Regulatory Period.....	13
3.4	Subsequent Regulatory Periods .....	19
3.5	Annual rate filings .....	20
3.6	Regulatory Reset Process .....	21
3.7	Service Quality Measures .....	21
3.8	Re-opening and Adjustment Events .....	21
3.9	Experts and Consultants.....	21

# 1. INTRODUCTION

## 1.1 Purpose

In January 2005, the Energy Regulatory Commission (ERC) adopted the Distribution Wheeling Rate Guidelines (DWRG) which had been developed through a public consultation process in 2004. The DWRG dated December 10, 2004 outline a Performance Based Regulation (PBR) framework using a price cap on the provision of distribution wheeling services by private electricity Distribution Utilities. This DWRG described the setting of rates under PBR, which the ERC has adopted as an alternative form of internationally-accepted rate-setting methodology under Section 43(f) of Republic Act No. 9136, otherwise known as the Electric Power Industry Reform Act of 2001 (EPIRA), and Rule 15, Section 5(a) of its Implementing Rules and Regulations (IRR).

During the Regulatory Reset Process for the First Entry Group, certain revisions were made to the DWRG. Following consultation, a new set of regulatory rules for PBR for Distribution Utilities were therefore issued - the Rules for Setting Distribution Wheeling Rates for Privately-Owned Distribution Utilities Entering Performance Based Regulation [First Entry Point], dated July 26 2006. These rules pertained specifically to the first Entry Group<sup>1</sup>. To provide for the Second (and subsequent) Entry Point(s) to PBR, the ERC conducted further consultation and published the Rules for Setting Distribution Wheeling Rates for Privately-Owned Distribution Utilities Entering Performance Based Regulation [Second and Later Entry Points] (RDWR) on December 13, 2006.

In terms of Section 1.9 of the RDWR, the rules may from time-to-time be amended by the ERC. The ERC has identified a number of required changes to the RDWR, mainly as a result of refinements identified during the Regulatory Reset Process for the first two Entry Groups into PBR and substantial changes to the required timelines for the reset process. These suggested changes are presented below.

Interested parties are requested to consider these proposed changes and to make submissions to the ERC in this regard, explaining their views on the proposed changes and highlighting any objection or suggested revision, with supporting justification or evidence. Submissions need not only focus on the changes suggested by the ERC, but may also include suggestions for further changes to the RDWR, along with the justification or evidence for suggesting these further changes.

The ERC will, after consideration of the submissions received and conducting public consultations in this regard, issue its final decision on the rule changes. This will also result in the issuing of a next revision of the RDWR which will in future form the basis for the regulation of and distribution price-setting for privately owned electricity distribution utilities.

---

<sup>1</sup> Annex B of ERC Resolution No. 12-02 Series of 2004 "Adopting a Methodology for Setting Distribution Wheeling Rates", dated December 10, 2004, defined five entry points into PBR for privately owned Distribution Utilities. This was later amended to four entry points by the ERC under resolution 24, series of 2007, dated October 24, 2007.

## **1.2 Use of terms and definitions in the Discussion Paper**

Throughout this discussion paper, where capitalized terms are used, this indicates that the term has been defined in clause 1.3 of the RDWR or clause 1.2 of the ERC's Distribution Services and Open Access Rules (DSOAR).

## **1.3 Outline of this paper**

This discussion paper is broadly structured along the sections of the RDWR. For each suggested change, the reference to the RDWR is provided, a high level description of the current rule is provided and the proposed change is discussed along with the reasons for the change.

This document is also accompanied by a revised version of the RDWR, in which the proposed changes have been included. These changes are highlighted for easy reference by interested parties.

## **1.4 Submissions on the Discussion Paper**

Submissions are invited on this Discussion Paper.

Any person with an interest in this matter and wanting to participate in the public consultation must become a party of record by formally making such request in writing to the ERC, providing a clear statement of the person's interest and their address for all correspondence, within twenty (20) days from the date of publication of this discussion paper.

For the public consultation, all parties of record shall file any comments, questions, suggested modifications to data sources, and any other issues pertaining to this decision paper in writing, to be received at the ERC offices at the 16<sup>th</sup> floor, Pacific Center, San Miguel Avenue, Ortigas Centre, Pasig City, not later than October 23, 2008. Any written submissions to the ERC in this case shall include six (6) paper copies and two (2) soft (electronic) copies provided on two (2) compact disks. The ERC shall publish such submissions on its web site by October 27, 2008. Any party filing written comments shall on the same day as the filing is made at the ERC serve as parties of record in the case.

Parties, who do not wish to partake in the public consultation, are also welcome to make submissions. Such submissions shall be submitted in the same format as that described above and at the same date.

The ERC hereby sets this matter for public consultation on October 28 from 9:00 A.M. to 5:00 P.M. at the ERC Hearing Room at the 15<sup>th</sup> Floor Pacific Center Building, San Miguel Avenue, Ortigas Center, Pasig City.

Although this consultation is open to public viewing, only parties of record who have filed written comments will be allowed to participate in the discussions. Should there be time before the end of the public consultation; the Commission shall allow verbal comments from other persons who have an interest in the proceedings. Parties of record are not required to have a lawyer present but are strongly encouraged to have technical experts present with knowledge of accounting, finance, engineering, energy-economics or pricing issues.

## 1.5 Process going forward

Following its consideration of the submissions on the Discussion Paper and the presentations at the public consultation session, the ERC will make its final decision on the proposed changes to the RDWR. This will be published not later than November 14, 2008.

In addition, an updated version of the RDWR will be published on the same date, taking into account the rule changes approved by the ERC.

## 1.6 Retrospective effect of the changes

It is the ERC's intention that, following its final decision on the changes to the RDWR, that these changes will apply not only to future entrants yet to enter PBR, but also to the remaining duration of the current Regulatory Period for the First Entry Group or the remaining duration of the Regulatory Reset Process and the Regulatory Period for the Second Entry Group. However, it is not the intention to:

- retrospectively revise any earlier regulatory decisions made, including rate-setting decisions;
- request the resubmission of any information or calculations previously submitted; or
- recalculate any revenue allowances or rate settings previously approved

under earlier versions of the RDWR. All historical regulatory decisions with respect to existing participants in PBR will therefore remain in force in spite of the rule changes creating situations where future similar decisions may result in different outcomes.

All future regulatory decisions, including the annual price reset arrangements, will however be made in terms of the revised RDWR, once this is issued by the ERC. If a future situation arises that in terms of the revised RDWR requires a reconsideration of the current price-control arrangements, this will be assessed and responded to under the revised RDWR.

## 2. GENERAL CHANGES TO THE RDWR

In this section a number of general changes to the RDWR are discussed. Given the general nature of these changes, specific cross-references to sections of the RDWR is not possible. However, in the attached consultation version of the RDWR, all the proposed changes have been made and highlighted.

These changes are all editorial in nature.

### 2.1 Proposed general changes

#### Change 1

<b>Topic</b>	Date references
<b>Issue</b>	The latest version of the RDWR is generic to all future Entry Groups and in order to accommodate this, all date references are cross-referenced to several different options.
<b>Proposed change</b>	Issue a version of the RDWR for each Entry Group, in which only the dates pertaining to that particular group are presented.
<b>Reason for change</b>	Relying on the cross-references makes it difficult to follow the timelines associated with Entry Groups later than the second and therefore compromises easy understanding of the RDWR.

Note : The dates in the attached consultation version of the RDWR are for the Third Entry Group. This is for reference only and will be adapted in the final RDWR to be published for each Entry Group.

#### Change 2

<b>Topic</b>	Reference to Initial Regulated Entity, First Regulatory Period and Subsequent Regulated Entity
<b>Issue</b>	The original DWRG and current RDWR envisaged a First Regulatory Period and associated Initial Entrants.
<b>Proposed change</b>	Remove all references to the First Regulatory Period, Initial Regulated Entity or Subsequent Regulated Entity except where these are essential to maintain clarity, the flow or the integrity of the document.
<b>Reason for change</b>	For all later entry groups there is no First Regulatory Period or Initial Regulated Entity. The only Initial Entrant (Cepalco) is now already in its Second Regulatory Period. The references to the First Regulatory Period or Regulated Entity are therefore redundant and sometimes confusing.

#### Change 3

<b>Topic</b>	Reference to privately owned distribution utilities
<b>Issue</b>	Current references in the RDWR is to PBR for “privately owned distribution utilities”
<b>Proposed change</b>	Expand all such references to “privately owned electricity distribution utilities”
<b>Reason for change</b>	PBR can also apply to different types of service providers, for example gas or water distribution utilities. External users may not at a glance understand that the RDWR is intended for electricity distributors only.

**Change 4**

<b>Topic</b>	References to “FM”
<b>Issue</b>	In several instances the RDWR refers to “FM” and in others to “Force Majeure”
<b>Proposed change</b>	Change all “FM” references to “Force Majeure”.
<b>Reason for change</b>	To retain consistency in the references.

### 3. SPECIFIC CHANGES

In this section the specific proposed changes to the RDWR are discussed. These changes follow the headings and sequence of the RDWR.

#### 3.1 Definition Changes

##### Change 5

<b>Section</b>	1.1
<b>Topic</b>	Intention and application of the proposed Rule changes
<b>Issue</b>	The revised RDWR should reflect the intention of the revisions and the purpose of the revised document.
<b>Proposed change</b>	Expand the background description of how the current revisions came about and the earlier versions of the rules for setting distribution rates. Also indicate that it is the intention to apply the revised rules to all Entry Groups, including those already under PBR, but that no retrospective ruling will be made or historical decisions altered.
<b>Reason for change</b>	This is required to inform interested parties on the purpose of the new consultation document and the purpose of the revised RDWR.

##### Change 6

<b>Section</b>	1.3
<b>Topic</b>	Definition of Ancillary Services
<b>Issue</b>	The current definition is too narrow
<b>Proposed change</b>	Expand the definition to include generation used for emergency supply purposes
<b>Reason for change</b>	Precedents were found in the Second Entry Group where generation facilities have to be maintained by Regulated Entities to provide standby power during short-term emergency situations affecting the bulk supply to the Distribution System. These are emergency situations beyond the control of the Regulated Entities but which occur relatively frequently. These generators are used for distribution support only and are not used for generation during normal operating circumstances.

##### Change 7

<b>Section</b>	1.3
<b>Topic</b>	Definition of Business Separation Guidelines
<b>Issue</b>	The current definition is too narrow
<b>Proposed change</b>	Expand the definition to clearly explain which document this definition is referring to.
<b>Reason for change</b>	To add clarity.

##### Change 8

<b>Section</b>	1.3
<b>Topic</b>	Definition of Captive Market
<b>Issue</b>	No definition exists in the current Rules

<b>Proposed change</b>	Include a definition of Captive Market, consistent with that used in the Business Separation Guidelines.
<b>Reason for change</b>	Clarity and consistency across regulatory documents.

**Change 9**

<b>Section</b>	1.3
<b>Topic</b>	Definition of Entry Group and Entry Point
<b>Issue</b>	No definitions exists in the current Rules
<b>Proposed change</b>	Include a definition of Entry Group and Entry Point.
<b>Reason for change</b>	Clarity of understanding.

**Change 10**

<b>Section</b>	1.3
<b>Topic</b>	Definition of Last Resort Supply Event
<b>Issue</b>	No definition exists in the current Rules
<b>Proposed change</b>	Include a definition of Last Resort Supply Event, consistent with that used in the Business Separation Guidelines.
<b>Reason for change</b>	Clarity and consistency across regulatory documents.

**Change 11**

<b>Section</b>	1.3
<b>Topic</b>	Definition of Position Paper
<b>Issue</b>	No definition exists in the current Rules
<b>Proposed change</b>	Include a definition of Position Paper, to explain this important regulatory document and step in the Regulatory Reset Process.
<b>Reason for change</b>	Clarity of understanding.

**Change 12**

<b>Section</b>	1.3
<b>Topic</b>	Definition of Regulated Retail Services
<b>Issue</b>	No definition exists in the current Rules
<b>Proposed change</b>	Include a definition of Regulated Retail Services, consistent with that used in the Business Separation Guidelines.
<b>Reason for change</b>	Clarity and consistency across regulatory documents.

**Change 13**

<b>Section</b>	1.3
<b>Topic</b>	Definition of a Relevant Tax
<b>Issue</b>	The current definition is incorrect and does not reflect the intent of the Tax Change Event clause
<b>Proposed change</b>	<p>Reduce the scope of those tax categories that will not be considered a Relevant Tax, so that Tax Change Events will apply to:</p> <ul style="list-style-type: none"> <li>• real property tax or any other tax on the ownership or occupancy of premises;</li> <li>• customs and import duties;</li> <li>• rates, taxes, fees and charges imposed by any Local Government or other local authority having taxation powers;</li> <li>• withholding tax; and</li> <li>• documentary stamp taxes or similar taxes and duties.</li> </ul>
<b>Reason for change</b>	<p>The provision for Tax Change Events is intended to allow a Regulated Entity to recover the costs associated with new or unforeseen major changes to taxes, fees, levies or duties that arise during a Regulatory Period and were not included in the allowed revenue requirements on which its price control arrangements for the Regulated Period were based.</p> <p>Since changes to certain taxes, including corporate income tax and franchise taxes or fees, are covered under alternative clauses, these taxes are intentionally excluded from this provision (they are not deemed a Relevant Tax). However, under the current rules, the taxes noted under the proposed change above are also excluded in spite of the fact that there is no recourse available to Regulated Entities to recover costs associated with major changes to these taxes. This contradicts the intent of allowing for Tax Change Events and therefore has to be changed.</p>

**Change 14**

<b>Section</b>	1.3
<b>Topic</b>	Definition of Retail Services
<b>Issue</b>	No definition exists in the current Rules
<b>Proposed change</b>	Include a definition of Retail Services, consistent with that used in the Business Separation Guidelines.
<b>Reason for change</b>	Clarity and consistency across regulatory documents.

**Change 15**

<b>Section</b>	1.3
<b>Topic</b>	<p>Definition of a Negative Tax Pass Through Amount</p> <p>Definition of a Positive Tax Pass Through Amount</p>
<b>Issue</b>	These definitions refer to clause 11.1.3 in the RDWR which no longer exists
<b>Proposed change</b>	Correct the references to section 11.1.1 (for the positive pass through) and 11.1.2 (for the negative pass through)
<b>Reason for change</b>	Correction required for the integrity of the rules

**Change 16**

<b>Section</b>	1.3 and section 10.2.4
<b>Topic</b>	Force Majeure Threshold Amount
<b>Issue</b>	The amount is not defined, in spite of references to it
<b>Proposed change</b>	It is proposed that the Force Majeure Threshold amount be set at 2.5% of the maximum average price for any year. In other words, the impact of a Force Majeure event can be separately recovered only if it would result in an additional cost per kWh that is equal or higher than 2.5% of the MAP for the year in which the event occurs. This will be reflected in a new clause, 10.2.6.
<b>Reason for change</b>	Correction required for the integrity of the rules

**Change 17**

<b>Section</b>	1.3
<b>Topic</b>	Rules of Practice and Procedure
<b>Issue</b>	No definition exists in the current Rules
<b>Proposed change</b>	Add a definition for the ERC's Rules of Practice and Procedure
<b>Reason for change</b>	All information submissions and proceedings related to the rate setting described in the RDWR should be done in accordance with the ERC's Rules of Practice and Procedure

**Change 18**

<b>Section</b>	1.3
<b>Topic</b>	Definition of Supplier of Last Resort
<b>Issue</b>	No definition exists in the current Rules
<b>Proposed change</b>	Include a definition of Supplier of Last Resort, consistent with that used in the Business Separation Guidelines.
<b>Reason for change</b>	Clarity and consistency across regulatory documents.

**3.2 Provision of Information****Change 19**

<b>Section</b>	1.8
<b>Topic</b>	Provision of information
<b>Issue</b>	The current rule does not provide the framework and requirements for information submissions.
<b>Proposed change</b>	Include a cross-reference to the ERC's Rules of Practice and Procedure, which guides information submission as well.
<b>Reason for change</b>	This is to ensure that all provision of information is done in strict accordance with the ERC rules.

**Change 20**

<b>Section</b>	1.8
<b>Topic</b>	Provision of information
<b>Issue</b>	No timeframe is given for the provision of information when requested by the ERC.
<b>Proposed change</b>	Add a clause 1.8.2 to describe the timeframe for information submission. A default period of ten working days is suggested for Regulated Entities to respond to written requests for information from the ERC. In exceptional cases this may be shortened, as pre-agreed with a Regulated Entity. The ERC may also extend the period if it considers that a substantial effort will be required to prepare the information, or at the request of a Regulated Entity – if so approved by the ERC.
<b>Reason for change</b>	To provide more clarity on the ERC requirements.

**3.3 Rate-setting during the Second Regulatory Period****Change 21**

<b>Section</b>	4.4.1
<b>Topic</b>	Tax adjustment formula
<b>Issue</b>	The terms of the tax-adjustment formula are incorrectly described
<b>Proposed change</b>	Correct references to $Tax_{p,n}$ (which should read $Tax_{p,t-2}$ ) and $CQ_t$ (which should read $CQ_{t-1}$ )
<b>Reason for change</b>	Correction required for the integrity of the rules

**Change 22**

<b>Section</b>	4.5
<b>Topic</b>	Change in weighted index
<b>Issue</b>	The existing weighting of 60/40 for local to international expenditure is too heavily weighted towards international expenditure
<b>Proposed change</b>	Change the default weighting to 80/20 for local to international expenditure.
<b>Reason for change</b>	Based on the evidence received from the first two entry groups (from their revenue applications), the proportion of local to international actual capital expenditure incurred is 65/35 and for operating expenditure 100/0. The combined proportion is 84/16.

**Change 23**

<b>Section</b>	4.8.2(c) and 4.8.2 (d)
<b>Topic</b>	Asset valuation – dates for delivering asset re-valuation report
<b>Issue</b>	The dates in the RDWR do not reflect the reset process requirements as experienced for the first two entry groups
<b>Proposed change</b>	The asset re-valuation report must be finalized at the latest 13 months prior to commencement of the Second Regulatory Period.

<b>Reason for change</b>	Based on experience during with the first two entry groups, if the valuation is not completed at least 13 months before the Regulatory Period, there is insufficient time for all the activities required during the rest of the Regulatory Reset Process. The timeline envisaged in the original DWRG and RDWR had to be substantially expanded to allow for increased requirements for public consultation and the associated public notice periods.
--------------------------	--

**Change 24**

<b>Section</b>	4.8.5
<b>Topic</b>	Asset valuation - asset categories
<b>Issue</b>	The categories in the RDWR do not perfectly match the requirements of the Business Separation Guidelines (BSG) and the Distribution System Open Access Rules (DSOAR).
<b>Proposed change</b>	Align the asset categories with the BSG and DSOAR
<b>Reason for change</b>	Correction required for the integrity of the overall price setting processes

**Change 25**

<b>Section</b>	4.8.5, 4.8.10 and (current) 4.8.12
<b>Topic</b>	Asset valuation – assets acquired after the Initial Re-valuation date.
<b>Issue</b>	The RDWR currently requires the asset valuation expert to provide advice on assets that will be acquired by Regulated Entities after the Initial Re-valuation date but before the start of the Second Regulatory Period.
<b>Proposed change</b>	The ERC should be responsible for determining the rolled-forward valuation of the regulatory asset base (RAB) at the start of the Second Regulatory Period. For this it will rely on the assistance of the expenditure review expert or review team who will be reviewing the capital expenditure forecasts submitted by the Regulated Entities. This change also makes (current) clause 4.8.12 redundant and it should be removed.
<b>Reason for change</b>	The asset valuation Regulatory Reset Expert does not have information about future capital expenditure. Evaluating the capital expenditure incurred after the Initial Re-valuation date but before the start of the Second Regulatory Period falls naturally under the scope of the expenditure review team or Regulatory Reset Expert, who is required to look at historical expenditure, current and forecast expenditure.

**Change 26**

<b>Section</b>	4.8.7
<b>Topic</b>	Asset valuation – date of initial re-valuation
<b>Issue</b>	The dates in the RDWR do not reflect the reset process requirements as experienced for the first two entry groups
<b>Proposed change</b>	The date of the Initial Re-valuation report should be changed to 15 months before the start of the Second Regulatory Period.
<b>Reason for change</b>	Since the asset re-valuation report now has to be delivered at the latest 13 months before the start of the Second Regulatory Period (see change 15), the Initial Re-valuation date has to be adapted accordingly, to allow sufficient time to complete the report.

**Change 27**

<b>Section</b>	4.8.5, 4.8.10 and 4.9.2
<b>Topic</b>	Construction work in progress factor (CWIP factor)
<b>Issue</b>	The CWIP factor currently only applies to the expenditure incurred between the Initial Re-valuation date and the start of the Second Regulatory Period.
<b>Proposed change</b>	Revise the rules to reflect that the CWIP factor will also apply to the opening asset base as well as capital expenditure incurred during the Second Regulatory Period.
<b>Reason for change</b>	Required for consistency and to fairly compensate Regulated Entities for capital tied up during construction. This is not provided for in the assets included in the opening asset base, as at the Initial Re-valuation date

**Change 28**

<b>Section</b>	4.11.2
<b>Topic</b>	Weighted average cost of capital (WACC)
<b>Issue</b>	The current Rules require the WACC to be the same for all Regulated Entities.
<b>Proposed change</b>	Revise the Rules to allow for a new WACC to be set at each Entry Point.
<b>Reason for change</b>	This is to retain consistency with the ERC's decision to recalculate the WACC at each Entry Point.

**Change 29**

<b>Section</b>	4.11.12 and 12.6
<b>Topic</b>	Weighted average cost of capital (WACC)
<b>Issue</b>	For each Entry Group, the WACC is currently fixed for the duration of the whole regulatory period. This approach is appropriate in jurisdictions where the WACC is a very stable parameter, which does not fluctuate materially in the short to medium term. However, in the environment experienced in the Philippines over the last 24 months, the WACC has fluctuated over a wide margin.
<b>Proposed change</b>	At each Entry Point, when the final WACC for that entry group is determined, the new WACC should be compared against that used for other Entry Groups already operating under PBR. If the newly calculated WACC varies by more than 10% from that used for previous Entry Groups, the WACC for the previous Entry Groups should be adjusted to the latest figure. This will require a re-opening event to recalculate the x-factor for the remaining part of the Regulatory Period for Entry Groups thus affected.
<b>Reason for change</b>	<p>Since the WACC is recalculated for each new Entry Point, this may lead to the situation that materially different WACC figures could apply to different entry groups. The WACC is one of the critical parameters in the price-setting process and wide variances in this figure could give rise to material distortions in the price-setting process, including:</p> <ul style="list-style-type: none"> <li>• An inequitable situation could arise between Regulated Entities, with some earning higher profits than other in spite of their actual efficiencies.</li> <li>• Distribution prices may vary substantially between Regulated Entities merely as a result of the setting of this single financial parameter and some consumers may be unduly penalized for unreasonably high returns, while others will unduly benefit from too low returns.</li> <li>• Investors in distribution networks could be receiving returns in excess of that</li> </ul>

	<p>warranted by the systemic risk of their investments, while in other cases they may be earning insufficient returns. Insufficient returns holds the danger of resulting in insufficient investment, which could affect the sustainability of networks.</p> <p>It is therefore necessary to adopt measures to allow the WACC to be changed during a regulatory period, if the divergence between the figures used for different Entry Groups becomes too large.</p>
--	--

**Change 30**

<b>Section</b>	4.12.1 and 4.12.8
<b>Topic</b>	Definition of major projects
<b>Issue</b>	The definition is too wide
<b>Proposed change</b>	The definition of major projects should be set at the smaller value of PhP 30 million or 20% of total annual capital expenditure.
<b>Reason for change</b>	During the initial reset periods it was found that the current definition is too wide and closer scrutiny of some smaller (but still substantial) projects is also warranted.

**Change 31**

<b>Section</b>	4.12.4, 4.12.5 and 7.1.5
<b>Topic</b>	Regulatory Expert for reviewing capital expenditure forecasts
<b>Issue</b>	The current Rules require that the ERC <u>must</u> retain a Regulatory Reset Expert for reviewing the capital expenditure programs of Regulated Entities.
<b>Proposed change</b>	Modify the Rules to allow the ERC to also use internal resources for this purpose.
<b>Reason for change</b>	The current Rules are too restrictive and the ERC may in future prefer to conduct this work in-house, or in cooperation with external experts.

**Change 32**

<b>Section</b>	4.12.6
<b>Topic</b>	Format of capital expenditure forecasts
<b>Issue</b>	The current Rules require capital expenditure forecasts to be made in nominal terms. It is also required to submit quarterly forecasts of inflation rates and exchange rates.
<b>Proposed change</b>	Capital expenditure forecasts should be provided in real and nominal terms, in accordance with the ERC's latest Regulatory Reset Issues Paper. Quarterly forecasts of inflation and exchange rates are not necessary – these should be based on Regulatory Years.
<b>Reason for change</b>	Expenditure reviews are more efficiently carried out on real figures, where the effect of inflation on expenditure can be ignored.

**Change 33**

<b>Section</b>	4.12.8
<b>Topic</b>	Historical capital expenditure figures
<b>Issue</b>	The current Rules only ask for historical expenditure records for five calendar years prior to the start of the Second Regulatory Period.

<b>Proposed change</b>	Historical expenditure figures are required for five calendar years as well as budgets for the Regulatory Year prior to the start of the Second Regulatory Period and for the period between the start of the calendar year in which the Second Regulatory Period starts and the start of the first Regulatory Year.
<b>Reason for change</b>	When a Regulated Entity starts on its Regulatory Reset Process, there is no further rate resets under the existing return-on-rate-base form of regulation. The ERC therefore does not have alternative opportunity to review and approve the utility's proposed expenditure for the period leading up to the start of the Regulatory Period. Furthermore, expenditure in the period directly before the start of the Regulatory Period is important in assessing current needs and future trends.

**Change 34**

<b>Section</b>	4.13.1
<b>Topic</b>	Operating and maintenance - categories
<b>Issue</b>	The categories in the RDWR do not perfectly match the requirements of the Business Separation Guidelines (BSG) and the Distribution System Open Access Rules (DSOAR).
<b>Proposed change</b>	Align the asset categories with that used in the latest Issues Paper, based on the classification in the BSG and DSOAR
<b>Reason for change</b>	Correction required for the integrity of the overall price setting processes

**Change 35**

<b>Section</b>	4.13.6
<b>Topic</b>	Format of operating and maintenance expenditure forecasts
<b>Issue</b>	The current Rules require operating and maintenance expenditure forecasts to be made in nominal terms. It is also required to submit quarterly forecasts of inflation rates and exchange rates.
<b>Proposed change</b>	Operating and maintenance expenditure forecasts (and forecast payments for taxes, levies and duties) should be provided in real and nominal terms, in accordance with the ERC's latest Regulatory Reset Issues Paper.  Quarterly forecasts of inflation and exchange rates are not necessary – these should be based on Regulatory Years.
<b>Reason for change</b>	Expenditure reviews are more efficiently carried out on real figures, where the effect of inflation on expenditure can be ignored.

**Change 36**

<b>Section</b>	4.13.1
<b>Topic</b>	Historical operating and maintenance expenditure figures
<b>Issue</b>	The current Rules only ask for historical expenditure records for five calendar years prior to the start of the Second Regulatory Period.
<b>Proposed change</b>	Historical expenditure figures are required for five calendar years as well as budgets for the Regulatory Year prior to the start of the Second Regulatory Period and for the period between the start of the calendar year in which the Second Regulatory Period starts and the start of the first Regulatory Year.

<b>Reason for change</b>	When a Regulated Entity starts on its Regulatory Reset Process, there is no further rate resets under the existing return-on-rate-base form of regulation. The ERC therefore does not have alternative opportunity to review and approve the utility's proposed expenditure for the period leading up to the start of the Regulatory Period. Furthermore, expenditure in the period directly before the start of the Regulatory Period is important in assessing current needs and future trends.
--------------------------	---

**Change 37**

<b>Section</b>	4.13.2
<b>Topic</b>	Historical expenditure figures on taxes, levies and duties (other than corporate income taxes)
<b>Issue</b>	The current Rules only ask for historical expenditure records for five calendar years prior to the start of the Second Regulatory Period.
<b>Proposed change</b>	Historical expenditure figures are required for five calendar years as well as budgets for the Regulatory Year prior to the start of the Second Regulatory Period and for the period between the start of the calendar year in which the Second Regulatory Period starts and the start of the first Regulatory Year.
<b>Reason for change</b>	When a Regulated Entity starts on its Regulatory Reset Process, there is no further rate resets under the existing return-on-rate-base form of regulation. The ERC therefore does not have alternative opportunity to review and approve the utility's proposed expenditure for the period leading up to the start of the Regulatory Period. Furthermore, expenditure in the period directly before the start of the Regulatory Period is important in assessing current needs and future trends.

**Change 38**

<b>Section</b>	4.13.4, 4.13.5 and 7.1.5
<b>Topic</b>	Regulatory Expert for reviewing operating and maintenance expenditure forecasts, as well as expenditure forecasts on taxes, levies and duties (other than corporate income taxes)
<b>Issue</b>	The current Rules require that the ERC <u>must</u> retain a Regulatory Reset Expert for reviewing the expenditure programs of Regulated Entities.
<b>Proposed change</b>	Modify the Rules to allow the ERC to also use internal resources for this purpose.
<b>Reason for change</b>	The current Rules are too restrictive and the ERC may in future prefer to conduct this work in-house, or in cooperation with external experts.

**Change 39**

<b>Section</b>	4.17
<b>Topic</b>	Force Majeure and Tax Event Pass Through
<b>Issue</b>	This applies to Initial Entrants only
<b>Proposed change</b>	Make this clause applicable to all entrants and remove reference to First Regulatory Period.
<b>Reason for change</b>	This clause only refers to Initial Entrants and is not relevant in its current form anymore.

**Change 40**

<b>Section</b>	4.23.3
<b>Topic</b>	Historical consumption and demand figures
<b>Issue</b>	The current Rules do not ask for historical demand and consumption figures.
<b>Proposed change</b>	Historical consumption and demand figures are required for five calendar years as well as budget figures for the Regulatory Year prior to the start of the Second Regulatory Period and for the period between the start of the calendar year in which the Second Regulatory Period starts and the start of the first Regulatory Year.
<b>Reason for change</b>	To effectively assess the forecast consumption and maximum demand figures for the Second Regulatory Period, it is essential to analyze historical trends.

**Change 41**

<b>Section</b>	4.23.3 (now 4.23.4) and 7.1.5
<b>Topic</b>	Use of Regulatory Experts
<b>Issue</b>	The current Rules require that the ERC <u>must</u> retain a Regulatory Reset Expert for reviewing the consumption and maximum demand of Regulated Entities.
<b>Proposed change</b>	Modify the Rules to allow the ERC to also use internal resources for this purpose.
<b>Reason for change</b>	The current Rules are too restrictive and the ERC may in future prefer to conduct this work in-house, or in cooperation with external experts.

**3.4 Subsequent Regulatory Periods****Change 42**

<b>Section</b>	5.5.4
<b>Topic</b>	Asset valuation
<b>Issue</b>	Use of roll-forward valuation rather than re-valuing the assets
<b>Proposed change</b>	Include requirement to maintain detailed capital expenditure records.
<b>Reason for change</b>	The ERC may decide to use a roll-forward valuation approach rather than re-valuing the assets at the start of the Third Regulatory Period. To allow this to be done efficiently, Regulated Entities detailed records of all capital expenditure incurred after the date of the Initial Revaluation are required.

**Change 43**

<b>Section</b>	5.8.4
<b>Topic</b>	Weighted average cost of capital
<b>Issue</b>	The Rules require the WACC to be the same for all Regulated Entities.
<b>Proposed change</b>	Revise the Rules to allow for a new WACC to be set at each Entry Point.
<b>Reason for change</b>	This is to retain consistency with the ERC's decision to recalculate the WACC at each Entry Point.

### 3.5 Annual rate filings

#### Change 44

<b>Section</b>	6.2 and 6.4
<b>Topic</b>	Rate filing requirements and timetable
<b>Issue</b>	The rate-filing procedure is not adequately described and the allowed timetable is insufficient.
<b>Proposed change</b>	Expand the description to better describe the filing procedure and to adapt the timetable so that it can be achieved prior to the scheduled start of the Second Regulatory Period. It will also be clearly indicated that the filing is both for an application for the new maximum average price (MAP) for a Regulatory Year and the translation of this MAP into distribution tariffs.
<b>Reason for change</b>	The current rules do not envisage a formal rate-filing procedure for adjusting the annual distribution rates as is now required by the ERC. Furthermore the current timetable does not allow sufficient time for this formal rate-filing procedure to run its course. There is also no indication that the MAP has to be translated into distribution tariffs.

#### Change 45

<b>Section</b>	6.4.1
<b>Topic</b>	Side constraints
<b>Issue</b>	Error in the side constraint formula
<b>Proposed change</b>	Correct the current formula as follows: $\frac{\left(\frac{FCH_{k,t}}{FQ_{k,t}}\right) - \left(\frac{CR_{k,t-1}}{AQ_{k,t-1}}\right)}{\left(\frac{CR_{k,t-1}}{AQ_{k,t-1}}\right)} \leq (CWI_t + SC_t)$
<b>Reason for change</b>	Error in the existing side constraint formula needs to be fixed for the integrity of the Rules

#### Change 46

<b>Section</b>	6.4.2 (new)
<b>Topic</b>	Side constraints
<b>Issue</b>	No flexibility in side constraints
<b>Proposed change</b>	Allow the ERC to relax the side-constraint condition in a situation of major under-recovery.
<b>Reason for change</b>	The side constraints are currently rigidly fixed. In situations where severe under-recovery exists, these side constraints limit the ability to effectively address the problem. This can result in a situation where under-recovery increases even further and could spiral out of control. Under the current Rules the ERC cannot intervene to avoid this.

### 3.6 Regulatory Reset Process

#### Change 47

<b>Section</b>	7.1
<b>Topic</b>	Regulatory Reset Process Timeline
<b>Issue</b>	The current timeline allowed in the Rules is insufficient.
<b>Proposed change</b>	Amend the timeline in accordance with the ERC's experience of the first two Regulatory Reset Processes.
<b>Reason for change</b>	The current timeline in the Rules does not allow sufficient provision for the filing and public hearing processes required at various stages of the Regulatory Reset Process.

#### Change 48

<b>Section</b>	7.2 (new)
<b>Topic</b>	Rate application prior to start of Regulatory Period
<b>Issue</b>	No description exists of the required rate application prior to the start of Regulatory Period.
<b>Proposed change</b>	Include a description of the requirement for a rate application and the timeline for this.
<b>Reason for change</b>	No description exists of the rate application required prior to the start of Regulatory Period. As part of the rate-setting process, the ERC's decision on the opening maximum average price has to be converted into distribution tariffs. This has to be filed by each Regulated Entity and subjected to a public hearing process.

### 3.7 Service Quality Measures

#### Change 49

<b>Section</b>	8.1
<b>Topic</b>	Timeline for establishing performance standards
<b>Issue</b>	The current timeline in the Rules does not conform with the actual experience of the ERC.
<b>Proposed change</b>	Match the timeline with the experience gained during the first two Regulatory Resets Processes.
<b>Reason for change</b>	The current timeline in the Rules does not conform with the actual experience of the ERC and allows insufficient time.

### 3.8 Re-opening and Adjustment Events

#### Change 50

<b>Section</b>	12.3 (new)
<b>Topic</b>	Re-opening in the event of material changes in consumption
<b>Issue</b>	Material changes in consumption could lead to major under- or excess recovery by Regulated Entities
<b>Proposed</b>	Allow for a re-opening event associated with major changes in the consumption

<b>change</b>	patterns for a Regulated Distribution System as compared with the original estimates included in the final determination on the price control arrangements for the Second Regulatory Period.
<b>Reason for change</b>	In terms of the RDWR Regulated Entities are supposed to bear the volume risk associated with changing consumption patterns, compared with what was originally forecast. Within reasonable limits, this is appropriate, since Regulated Entities can to some extent adapt their expenditure patterns according to consumption patterns. However, if consumption changes substantially from forecast levels, the associated risk of over- or under-compensation becomes excessive.  It is therefore prudent to put a threshold on the acceptable level of change that would be accepted. If this is exceeded, the forecast consumption figures have to be adapted.

**Change 51**

<b>Section</b>	12.4
<b>Topic</b>	Re-opening for major unforecasted acquisitions
<b>Issue</b>	The boundaries for this clause are unrealistic
<b>Proposed change</b>	Change the boundaries for acquisitions that were not forecast to PhP 75 million or 3% of the value of the asset base.  Change the value of over- or under-expenditure on major projects requiring a re-opening of the X-factor to greater than 130% or less than 70% of the originally forecast values.
<b>Reason for change</b>	The current boundaries for allowing unforeseen expenditure are too high at PhP 150 million, and too low at 1.5% of the total asset value.  Similarly, the margin for uncertainty on major capital projects is too narrow at $\pm 10\%$ - this is well within the expected uncertainty range for desktop design estimates.

**3.9 Experts and Consultants****Change 52**

<b>Section</b>	14.4
<b>Topic</b>	Sharing the cost of Regulatory Reset Experts
<b>Issue</b>	The current description in the Rules of cost-sharing for the Regulatory Reset Expert costs is incorrect.
<b>Proposed change</b>	Change the cost-sharing requirements to reflect that all Regulated Entities contribute to all regulatory reset costs, not just those at each entry point.  Make provision for a change to the Measurement Period (on which the current proportional cost allocations are based) at the next Regulatory Period.  Remove the requirement to separately account for certain costs on a per Regulated Entity basis.  Add an appendix F to show the current proportional contribution to the Regulatory Reset costs by each Regulated Entity.
<b>Reason for change</b>	The current description in the Rules of cost-sharing for the Regulatory Reset Expert costs is inconsistent with the actual arrangements in place, and provide for the costs of each Regulatory Reset Process to be borne only by the entrants at that Entry Point.  It is also envisaged that the costs for certain activities, where these relate specifically to a Regulated Entity, will be borne by that Regulated Entity alone. In practice this

	has proved to be impractical to administer, since projects have been allocated for whole Entry Groups and large proportions of work is carried out on a communal basis. Separate record-keeping of actual costs incurred per Regulated Entity would add a major administrative burden and could result in un-equitable cost-distribution between consumers of different Regulated Entities.
--	---

Pasig City, Philippines,

  
**ATTY. FRANCIS SATURNINO C. JUAN**  
Executive Director



