



**REVIEW OF OPERATING AND MAINTENANCE
EXPENDITURE (OPEX) FORECAST:
SECOND REGULATORY PERIOD**

Tarlac Electric, Incorporated (TEI)

ADDENDUM

Prepared

by the

ENERGY REGULATORY COMMISSION (ERC)

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1. INTRODUCTION

The Energy Regulatory Commission (ERC) has promulgated a performance-based form of regulation (PBR) for regulated privately owned electricity distribution utilities in the Philippines. Under the PBR framework, a regulated entity will be subject to a price cap for the delivery of distribution wheeling services. The reset process for the setting of the price cap for the six regulated entities entering the PBR at the third entry point is currently underway. This process will result in the setting of a maximum price path that will determine the maximum average price a regulated entity can charge for each year of the Second Regulatory Period (which commences on July 1, 2010 and ends on June 30, 2014).

The mechanism for the calculation of the price cap and the procedure and timelines for the introduction of this cap, are described in the Rules for Setting the Distribution Wheeling Rate (RDWR), which was released by the ERC on December 8, 2008¹. The ERC has also formulated its position on the reset process – as set out in a Position Paper dated December 8, 2008².

An important requirement of the reset process going forward is the review of the expenditure forecasts submitted by the DUs as part of their revenue applications filed with the ERC. These expenditure forecasts are critical to the determination of the revenue to which DUs are entitled and on which the price caps will be determined.

Section 4.13.4 of the RDWR requires that the expenditure forecasts provided by a DU be reviewed by a Regulatory Reset Expert/s in isolation or in cooperation with ERC staff as part of the PBR regulatory reset process. Geoff Brown and Associates (GBA) has been engaged by the ERC to provide guidance to the ERC staff to review the operating and maintenance expenditure (OPEX) forecasts and review the capital expenditure (CAPEX) forecasts, as well, of the six DUs entering PBR at the third entry point.

TEI submitted its PBR revenue application to ERC on June 15, 2009³ (Revenue Application). The Commission issued its report on its review of the operating and maintenance expenditure forecasts included in TEI's Revenue Application on October 19, 2009⁴ (Review of Operating and Maintenance Expenditure (OPEX) Forecast: Second Regulatory Period). ERC issued a draft determination on the Revenue Application on November 9, 2009⁵ (Draft Determination). Following the release of the Draft Determination, ERC held a public consultation in Tarlac City on January 26, 2010. At the public consultation TEI raised a number of issues in respect of the Draft Determination and was required by the ERC to subsequently provide additional information to support its position. GBA and ERC staff were present at the public consultation and have now reviewed the additional information supplied by TEI insofar as this information relates to CAPEX forecasts which may result to corresponding OPEX adjustments. In this Addendum to the Review of the Operating and Maintenance Expenditure Forecasts: Second Regulatory Period, ERC documents its review of the issues raised and, where appropriate, modifies the recommendations in the Review of the Operating and Maintenance Expenditure (OPEX) Forecast: Second Regulatory Period on TEI's reasonable OPEX requirements for the second regulatory period.

TEI has no submission on the OPEX forecasts allowed in the Draft Determination. Nevertheless, CAPEX adjustments recommended by GBA impacts on the OPEX approved in the Draft Determination. These are discussed in detail in the body of this Addendum.

¹ *Rules for Setting Distribution Wheeling Rates (RDWR) for Privately Owned Distribution Utilities Entering Performance Based Regulation (Third Entry Point)*, Energy Regulatory Commission, December 8, 2008.

² *Regulatory Reset for the July 2010 to June 2014 Regulatory Period for the Third Entry Group of Privately Owned Distribution Utilities subject to Performance Based Regulation, Position Paper*, Energy Regulatory Commission, December 8, 2008. Note that the start and finish dates of the regulatory period to which the Position Paper applies were subsequently changed to July 1, 2010 and June 30, 2014 respectively, by ERC resolution No. 24, Series of 2007, dated October 24 2007.

³ ERC Case No 2009-042RC.

⁴ *Review of Operating and Maintenance Expenditure (OPEX) Forecast: Second Regulatory Period, Tarlac Electric, Incorporated. (TEI), ERC*, October 19, 2009.

⁵ *Regulatory Reset for Tarlac Electric, Incorporated.(TEI) July 2010 to June 2014 (Second Regulatory Period) Draft Determination*, Energy Regulatory Commission, November 9, 2009.

2. EXECUTIVE SUMMARY

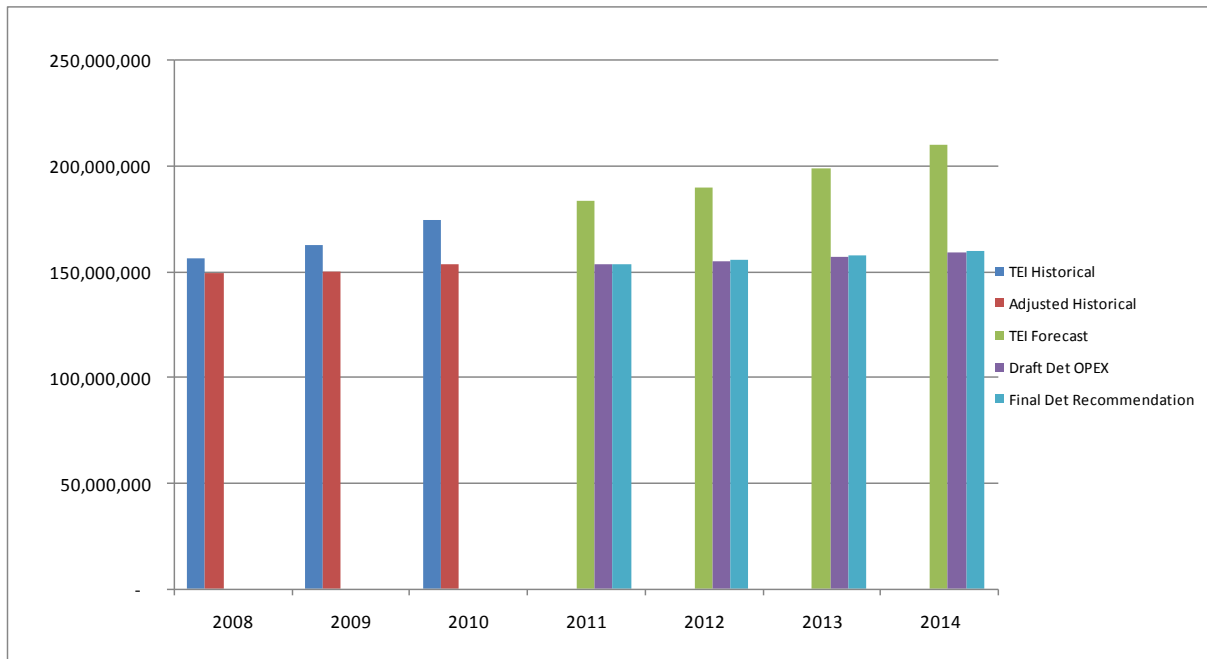
ERC made adjustments to the OPEX forecast allowed in the Draft Determination considering GBA's recommended adjustments in the CAPEX forecasts as follows:

Table 1: Operating and Maintenance Expenditure Forecasts (PhP million, real 2009)

	RY 2010	RY 2011	RY 2012	RY 2013	RY 2014	Total ¹
Draft Determination	154.23	153.92	155.22	157.31	159.22	779.90
Adjustment to <i>Distribution Operating and Maintenance</i>	-0.46	-0.42	0.22	0.73	0.88	0.92
Adjustment to <i>Administration and General</i>	-0.05	-0.04	0.03	0.10	0.11	0.15
Adjustment to <i>Regulated Retail Services</i>	0.01	0.01	0.01	0.01	0.01	0.06
Total Adjustments	-0.50	-0.47	0.26	0.84	1.00	1.13
Revised Recommendation	153.73	153.45	155.48	158.15	160.22	781.03

The CAPEX adjustments, being increases in major projects, correspondingly increase the OPEX. Changes in the CAPEX timings also correspondingly change the timing of the OPEX.

The impact of these adjustments to the OPEX allowed in the Draft Determination is shown in the figure below.



ERC made no further adjustments to the taxes, levies and duties allowed in the Draft Determination.

3. OPERATING AND MAINTENANCE EXPENDITURE

3.1 OPEX MODEL

The OPEX forecasting model escalates the actual OPEX in the base year (after adjustment for abnormal base year expenditures and review for efficiency) to reflect the impact of anticipated changes in significant cost drivers over the forecast period.

As described in the OPEX Review Report, the OPEX model forecasts specific cost categories by escalating the base year values by the correlated cost drivers. The distribution operating and maintenance expenditures are correlated to the growth in regulated assets, regulated retail costs are closely aligned to the growth in customer numbers, the water and electricity costs is aligned with the number of staff and the total OPEX is also affected by the prices in materials and labour costs. One of the significant cost drivers used to forecast the OPEX is the asset growth rate which is will change if there is an increase or decrease in its capital expenditure forecast.

In this regard, ERC remodelled the OPEX to account for the impact of the revised CAPEX recommendations of GBA., as follows:

Table 3.7: Comparison of Draft Determination and ERC Forecast Operating and Maintenance Expenditure (PhP million, real 2009)

Operating and Maintenance Expenditure Category	2010	2011	2012	2013	2014	Total ¹
Distribution and Connection Services Operation and Maintenance						
Draft Determination	43.80	42.29	42.03	42.58	42.97	213.66
Adjusted OPEX Model	43.34	41.86	42.24	43.31	43.84	214.58
Difference	-0.46	-0.42	0.22	0.73	0.88	0.92
Administrative and General						
Draft Determination	49.07	49.18	49.29	49.35	49.39	246.30
Adjusted OPEX Model	49.02	49.14	49.33	49.45	49.51	246.45
Difference	-0.05	-0.04	0.03	0.10	0.11	0.15
Regulated Retail Services						
Draft Determination	61.36	62.44	63.9	65.37	66.86	319.94
Adjusted OPEX Model	61.38	62.46	63.91	65.39	66.87	320.00
Difference	0.01	0.01	0.01	0.01	0.01	0.06
Total Operating and Maintenance Expenditure						
Draft Determination	154.23	153.92	155.22	157.31	159.22	779.90
Adjusted OPEX Model	153.73	153.45	155.48	158.15	160.22	781.03
Difference	-0.50	-0.47	0.26	0.84	1.00	1.13
OPEX Adjustment	-0.50	-0.47	0.26	0.84	1.00	1.13

¹ It includes RY2010 plus the Second Regulatory Period which comprises a four-year regulatory period

4. TAXES, LEVIES AND DUTIES

There were no comments submitted on the taxes, levies and duties forecast. ERC recommends no changes to the forecast taxes, levies and duties.

4.1 RECOMMENDATION

ERC considers that the taxes, levies and duties allowed in the Draft Determination are sufficient to enable TEI to pay its tax liabilities on time and that no further adjustment is necessary.

