

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

IN THE MATTER OF THE
APPLICATION FOR APPROVAL OF
THE UNBUNDLED RATES PURSUANT
TO THE PROVISIONS OF REPUBLIC
ACT NO. 9136

ERC CASE NO. 2001-949

**NEGROS ORIENTAL II ELECTRIC
COOPERATIVE (NORECO II),**

Applicant.

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DECISION

Before this Commission for resolution is the application filed on December 20, 2001 by applicant Negros Oriental II Electric Cooperative, Inc. (NORECO II) for approval of its unbundled rates pursuant to the provision of Republic Act No. 9136.

Relative to said application, the Commission issued an Order dated February 8, 2002, directing NORECO II to submit the following additional data/documents. On February 26, 2002, NORECO II filed its "Additional

Compliance” submitting therewith a new set of documents in substitution of the previously submitted documents.

Having found said application sufficient in form and substance with the required fees having been paid, an Order and a Notice of Public Hearing, both dated April 19, 2002, were issued setting the case for initial hearing on June 13, 2002.

NORECO II was directed to cause the publication of the Notice of Public Hearing, at its own expense, twice (2x) for two (2) successive weeks in two (2) newspapers of general circulation in the country, the last date of publication to be made not later than two (2) weeks before the scheduled date of initial hearing. In compliance with the said directive, NORECO II published the Notice of Public Hearing in the “*Malaya*” and “*Balita*” both on May 9 and 16, 2002.

The Office of the Solicitor General (OSG), the Commission on Audit (COA) and the Committees on Energy of both Houses of Congress were furnished with copies of the Order and the Notice of Public Hearing and were requested to have their respective duly authorized representatives present at the aforesaid initial hearing.

Likewise, the Mayors of the City/Municipalities of Dumaguete City, Bacong, Basay, Bayawan, Dauin, Pamplona, San Jose, Siaton, Sibulan, Sta. Catalina, Tanjay, Valencia, Zamboanguita and Amlan, all in the Province of

Negros Oriental, were furnished with copies of the Order and the Notice of Public Hearing for the appropriate posting thereof on their respective bulletin boards.

At the initial hearing on June 13, 2002, Atty. Zenon Suarez appeared as counsel for NORECO II. No oppositor appeared nor was there any opposition registered.

During said hearing, NORECO II submitted proofs of its compliance with the Commission's publication and posting of notice requirements which were duly marked as Exhibits "A" to "C-13", inclusive. Thereafter, NORECO II moved for the deferment of the presentation of its witnesses as it needed to make certain revisions on the documents it had submitted in order to conform with the Commission's Uniform Rate Filing Requirements (UFR). Said motion was granted. Thus, the hearing was reset to August 2, 2002.

On July 11, 2002, NORECO II submitted its "Post Hearing Submission" together with the recomputed data based on its audited financial statements.

At the August 2, 2002 hearing, only the counsel for NORECO II appeared. Again, no oppositor appeared nor was there any opposition registered.

During the August 2, 2002 hearing, NORECO II presented two (2) witnesses. The first witness, Ms. Eunora Y. Sameon, NORECO II's Controller,

testified on certain relevant schedules and on the documents submitted in support of the application and on other matters related to the application. In the course of her testimony, additional documents were presented, identified by reference and marked as Exhibits "D" to "Y", inclusive. Thereafter, the Commission propounded clarificatory questions on the same witness.

The second witness, Engr. Chito Losano, the Technical Assistant to NORECO II's General Manager, testified on the various technical aspects of the application including its system loss and proposed program for the development and improvement of its services. After the termination of the direct examination, the Commission propounded clarificatory questions on the same witness.

The Commission, in its Order dated August 5, 2002, reiterated its directives given in open court for NORECO II to submit, within fifteen (15) days from August 2, 2002, the following documents/data: (a) a proposal as to how its proposed lifeline rate will be subsidized; (b) its proposal as to what actions will be undertaken regarding its power bills inventory amounting to about PhP 66 Million; (c) a prioritization of the projects subject of its re-investment fund; and (d) a schedule of outages for the years 2000 to 2002.

On August 26, 2002, NORECO II filed its "Second Post Hearing Submission".

On May 30, 2003, NORECO II filed its “Formal Offer of Evidence” (FOE) which was admitted by the Commission for the purposes for which they were being offered. With the applicant having rested its case with the filing of said formal offer and having submitted all the additional documents required by the Commission, this case is now ripe for resolution.

I. SUMMARY OF NORECO II's APPLICATION

I.A. REVENUE REQUIREMENT

NORECO II's revenue requirement per unbundled application based on historical year 2000 was as follows:

ACCOUNT NAME	TEST YEAR
kWh Sales	97,957,451
Purchased Power	PhP 356,192,815
Payroll	42,716,554
Operation & Maintenance (less Purchased Power & Payroll)	40,560,975
Debt Service Plus Cash Working Capital	18,709,695
Less: Other Revenue Items	0
Reinvestment Fund (8%) ¹	36,654,403
TOTAL REVENUE REQUIREMENT	PhP 494,834,442

¹ In the UFR, this item is reflected as “Plus Percentage for Cooperative Investment”.

NORECO II's proposed revenue requirement was PhP 494,834,442 based on historical test year 2000 as evidenced by the published and submitted Overall Average Tariff Adjustment (OATA) of PhP 0.3109/kWh.

NORECO II also submitted Audited Financial Statements for the year 2000.

I.B. RATE STRUCTURE/DESIGN

The unbundled rates proposed by NORECO II were as follows:

Residential		
Energy Charge	PhP	5.1229/kWh
Retail Customer Charge		19.60/customer/month
Metering Charge		10.40/ customer/month
Commercial		
Energy Charge		4.4942/kWh
Retail Customer Charge		28.99/customer/month
Metering Charge		21.01/customer/month
Industrial		
Demand Charge		105.17/NCP kW
Energy Charge		4.0439/kWh
Retail Customer Charge		118.79/customer/month
Metering Charge		181.21/customer/month
Public Buildings		
Energy Charge		4.5380/kWh
Retail Customer Charge		35.51/customer/month
Metering Charge		34.49 /customer/month
Street Lights		
Energy Charge		4.3697/kWh
Retail Customer Charge		75.00/customer/month
Irrigation		
Energy Charge		4.2350/kWh
Retail Customer Charge		86.94/customer/month
Metering Charge		153.06/customer/month

BAPA	
Energy Charge	4.7850/kWh
Retail Customer Charge	36.43/customer/month
Metering Charge	33.57/customer/month
High Voltage	
Demand Charge	138.10/NCP kW
Energy Charge	3.9341/kWh
Retail Customer Charge	315.60/customer/month
Metering Charge	684.40/customer/month

I.B.1. FUNCTIONALIZATION, CLASSIFICATION and ALLOCATION

All the functionalization and the allocation factors used by NORECO II were default factors provided in the Uniform Rate Filing Requirements (UFR) prescribed by the Commission. These were adopted by NORECO II as applicable to its operations.

I.B.2. SYSTEM LOSS

The actual system loss for the year 2000 was 12.23%. NORECO II adopted the actual purchased power cost net of Primary Voltage and Power Factor Discounts.

Witness Losano considered 87% of the system loss as the technical factor and the remaining 15% is for non-technical factor (TSN dated August 2, 2002, page 47).

Witness Losano stated (TSN dated August 2, 2002, pages 51-52) that following program plan for the reduction of system loss for the coming years 2002-2007 are the following, (1) construction of an additional power sub-station to address the increasing demand in their system, (2) upgrading of equipment, distribution lines and existing sub-station to improve power factor, (3) information campaign to reduce pilferages and (4) acquisition of new software such as automated AM/FM GIS software and consumer metering, metering clustering and distribution transformer utilization.

I.B.3. INTER-CLASS CROSS SUBSIDY

NORECO II provided the amounts of cross subsidies for each customer type but did not include a program for the removal thereof.

CUSTOMER TYPES	ADJUSTED EXISTING (PhP)	PROPOSED (PhP)	INTER-CLASS CROSS SUBSIDIES (PhP)
Residential	243,281,040	266,871,182	23,590,142
Commercial	134,108,506	122,809,589	(11,298,917)
Industrial	14,842,238	14,253,705	(588,533)
Public Buildings	28,421,932	26,048,368	(2,373,564)
Street Lights	10,551,152	9,462,130	(1,089,022)
Irrigation/Water System	12,277,575	10,644,013	(1,633,562)
BAPA	1,882,066	1,784,563	(97,503)
High Voltage	49,469,933	42,960,892	(6,509,041)
TOTAL	494,834,442	494,834,442	0

I.B.4. LIFELINE RATE and LEVEL

NORECO II proposed the following level and rate for marginalized end-users:

	Option 1 (At Existing Rates)	Option 2 (At Proposed Customer Charges)
Level	10 kWh	10 kWh
Rate	PhP 4.7306/kWh	PhP 30.00/customer/month

I.C. OTHER CHARGES

NORECO II, in its subsequent submission, provided this Commission with information on its existing Other Charges as shown below. NORECO II did not propose any adjustment to these charges.

<u>PARTICULARS</u>	<u>PhP/UNIT</u>
CONNECTION FEES	
Residential	300
Commercial	300
Industrial w/Instrument transformer	550
Irrigation	300
Street Lights	300
Public Building	300
BAPA	300
High Voltage	800

OTHER SERVICE CHARGES

A. RECONNECTION FEES		
Residential/Public Building		60
Commercial		60
Industrial		500
Irrigation		60
St. Lights		60
BAPA		60
High Voltage		500
B. SERVICE FEE FOR TEMPORARY CONNECTION		
Peryahan/Bgy. Or Town Fiesta		300
Basketball League		300
Cemetery		300
Welding		300
C. SERVICE FEE FOR RELOCATION OF KILO-WATT-HOUR METER		
Single Phase Meter		200
Three Phase Meter		
a. Secondary Metering Self Contained Meter		500
		PhP/UNIT
b. Secondary Metering Instrument Rated Meter		1,000
c. Primary Metering with Instrument		2,000
D. SERVICE FEE FOR CALIBRATION OF KILO-WATT-HOUR METER		
Bottom type		
Socket type Class 100		100
Socket type Class 200		100
Potential Transformer		200
Current Transformer		200
Three Phase Meter		
Self-Contained		300
Instrument Rated		300
E. SERVICE FEE FOR INSTALLATION OF SOLE USE TRANSFORMER		
10 – 25 KVA		300
37.5 – 100 KVA		400
167 – 500 KVA		600

F. SERVICE FEE FOR PULL DOWN OF SOLE USE
TRANSFORMER

10 – 25 KVA	150
37.5 – 100 KVA	200
167 – 500 KVA	300

**CORE LOSS CHARGES FOR TRANSFORMER
SOLE USERS**

	RATINGS	kWh LOSS/MO.
	10 KVA	50
	15	60
	25	85
	37.5	120
	50	135
	75	205
	100	255
	167-500	360

II. COMMISSION DISCUSSIONS AND CONCLUSIONS

II.A. DETERMINATION OF TOTAL REVENUE REQUIREMENT

II.A.1. TEST YEAR

The Commission finds NORECO II's proposal to use the test year 2000 in its unbundled rate application acceptable since it is consistent with Rule 15 Section 6(c) of the Implementing Rules and Regulations (IRR) of R.A. 9136. Therefore, the discussions and conclusions that follow are based on Schedule A, adjusted to audited financial statement figures for historical test year 2000.

II.A.2. GENERATION and TRANSMISSION COSTS

At present, NORECO II is buying power from three (3) sources, namely: National Power Corporation (NPC), Negros Occidental Electric Cooperative, Inc. (NOCECO) and Negros Oriental I Electric Cooperative, Inc. (NORECO I). The Commission notes that the contractual arrangements between NORECO II and its two suppliers (NORECO I and NOCECO) have no prior approval from the Energy Regulatory Board (ERB). The Commission further notes that the power rate charged by NOCECO and NORECO I are higher than that of NPC. In view thereof, the Commission limits the purchased power rates to that not exceeding the NPC rate.

The Generation Charges shall reflect the generation charge as provisionally authorized by the Commission in the joint filing of National Power Corporation (NPC) and Power Sector Assets and Liabilities Management Corporation (PSALM) in its Order dated September 29, 2003, Case No. 2003-291 [In the Matter of the Application for the Approval of the Revised Unbundled Generation Tariffs] and the revised methodology designated as the “Long-Run Avoidable Cost” (LRAC) methodology in lieu of the “Return on Rate Base” (RORB) methodology for the determination of the NPC’s generation rates.

For the Visayas Grid, the LRAC shall be applied on a staggered basis in order to mitigate the impact of the increase in generation rates on the part of the consumers (please refer to Section II.B.2.b. for details). Pursuant to the afore-

stated Order, the implementation of NPC's Generation Rate Adjustment Mechanism (GRAM) and FOREX in the Luzon, Visayas and Panay/Bohol is terminated upon the effectivity of the approved rates based on the LRAC Methodology.

Further more, the Generation Charges shall also reflect the Incremental Currency Exchange Rate Adjustment (ICERA) as approved in ERC Order dated December 4, 2003, Case No. 2003 – 498 [In the Matter of the Adoption of the Incremental Currency Exchange Rate Adjustment, of National Power Corporation (NPC) and Power Sector Assets and Liabilities Management Corporation (PSALM), Applicants] . The ICERA rate of PhP (0.0065)/kWh will be implemented by NPC and PSALM within a period of six months starting December 2003 to May 2004.

The Transmission Charges shall reflect the transmission charges of the National Transmission Corporation (TRANSCO) as approved in ERC Orders dated September 6 and 20, 2002, Case No. 2001-901 (In the Matter of the Application for the Approval of the Revised Unbundled Power Rates, National Power Corporation (NPC) – Applicant). A separate charge to account for the allowable system losses shall likewise be provided (please refer to Section II.B.2.d. for details). Hence, a distribution utility with a system loss that is within

the allowable cap can recover from its end-users the total cost of the generation and transmission. *Annualization*² of the billing determinants was applied.

The adjustment made by the Commission to Purchased Power Cost of PhP 57,760,973 pertains to the difference between the proposed purchased power of NORECO II amounting to PhP 356,192,815 and the purchased power cost based on the new rates of NPC and TRANSCO amounting to PhP 413,953,788. The Commission adjusted NORECO II's recoverable system loss (see Section II.B.2.d. for discussion).

Records show that NORECO II's actual system loss for the year 2000 was 12.23%. However, based on its 2000, 2001 and 2002 financial and statistical report, NORECO II has an average of 13.9972% system loss (excluding cooperative's own use). Thus, the system loss considered in the rate design was based on the average system loss for period of 2000 to 2002 which is 13.9972%. The Commission allowed NORECO II's average system loss of 13.9972% in the calculation of revenue requirement as discussed in Section II.B.2.d. of this Decision.

Based on the new NPC generation charges and transmission charges, as well as the allowable system loss, the Commission sets NORECO II's

² *The annualization of kWh sales is calculated by multiplying the average kWh consumption of a specific customer class by their respective year-end number of customers.*

unbundled Generation, Transmission and Recoverable System Losses as follows:

Generation Charge	PhP	271,817,201
Transmission Charge		83,499,245
Recoverable System Losses		58,637,342
Total	PhP	413,953,788

NORECO II's approved generation charge shall remain fixed until changes in NPC's generation rate are approved and authorized by the Commission pursuant to its Order dated September 29, 2003, ERC Case No. 2003-291 [In the Matter of the Application for the Approval of the Revised Unbundled Generation Tariffs, National Power Corporation (NPC) and Power Sector Assets and Liabilities Management Corporation (PSALM) – Applicant]. In which case, NORECO II shall bill its end-users the new generation rate charged by NPC. In the meantime; NORECO II shall discontinue charging the Purchased Power Adjustment (PPA) upon effectivity of the unbundled rates.

II.A.3. PAYROLL

The Commission made an upward adjustment on the payroll account by PhP 269,709 bringing this to the current salary level of PhP 42,986,263 This took into account the implemented salary rate level plus 13th month pay allowance per NORECO II Board of Director's Resolution No. 390A Series of

2002, which was reduced by the disallowed expenses charged under payroll account and those reclassified to O & M account.

The Commission reviewed the Wage Adjustment Clause (WAC) Formula authorized by the then Energy Regulatory Board through ERB Case Nos. 94-25 and 94-96. The then Board allowed the implementation of the WAC Formula based on three established criteria for it to be classified under automatic adjustment clauses. These are: 1) when such costs are extremely volatile, changing rapidly over a short period of time; 2) when such volatile cost changes represent significant portions of total utility operating expenses; and 3) when such volatile cost changes are beyond the ability of the utility to control.

Analysis shows that the wage adjustments do not warrant an automatic recovery clause. The Commission therefore rules that the application of the WAC Formula be discontinued. The growth in kWh sales will be sufficient for the electric cooperatives to absorb increases in salaries/wages mandated by wage orders.

The Commission noted that NORECO II did not avail of the WAC Formula.

II.A.4. OPERATION and MAINTENANCE (less Purchased Power and Payroll)

In general, operating expenses allowed are those which are reasonably incurred in connection with business operations to yield revenue or income.

These should be required or necessary in the operation of a utility, are recurring, and should redound to the service or benefit of end-users.

The Commission enjoins NORECO II to incur only “prudent and reasonable costs” for inclusion in the determination of retail rates. While a distribution utility enjoys the benefit of passing its costs of purchased power and other reasonable costs to end-users, it is obligated as a public utility to ensure that its costs of operations, including payroll, are kept at a minimum. The distribution utility must bear in mind that its very nature is that of a service company for its end-users, with a mandate to advocate and transact judiciously for and in their behalf.

“Reasonable costs” may be defined as the cost of those goods and services which, while may not be the lowest in price, need to be incurred with consideration of quality, efficiency, reliability and security, which are characteristics of the service that should be delivered by the distribution utility. “Prudent costs” demand that the utility ensures that its purchases of goods and services are at their minimum, without sacrificing the foregoing characteristics. When making a purchase or executing a contract, it cannot simply rely on its right to pass on its costs to its end-users.

As such, the Commission, in fulfillment of the policy of R.A. 9136 to establish a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency, enjoins NORECO II to

institute and report to the Commission its policies and procedures for cost-cutting and for the transparent and competitive procurement of goods and services.

NORECO II's end-users have a right to receive safe, reliable and adequate service at a reasonable rate. On the other hand, these end-users should pay their power bills on time to ensure NORECO II's viability. To this end, NORECO II should view a petition for an increase in rates to be the last recourse. In future filings, NORECO II should be reminded that it has the burden of proving that all reasonable and appropriate cost-cutting measures have been taken, before resorting to a petition to increase rates.

The Commission made a downward adjustment of PhP 3,183,578 on NORECO II's Operation and Maintenance (O & M) Expenses, as follows:

Excluded Expenses

Amount in the UFR that exceeds what is allowed under NEA Guidelines

Grocery Allowance	PhP	1,847,100
Group Insurance		1,336,478
Total Excluded Expenses	Php	<u>3,183,578</u>

The total excluded expenses translate to PhP 0.0319/kWh, which the Commission considers material.

For future rate cases, NORECO II will continually be required to make full disclosure of all its O & M Expenses for the Commission to determine the prudence of its expenditures. NORECO II should ensure that procedures are put in place so that all expenditures that are included in the determination of revenue requirements are adequately documented and that such documentation is reasonably accessible to ERC.

II.A.5. OTHER REVENUE ITEMS

The Commission defines Other Revenue Items (ORI) as revenues earned (net of other expenses) by the electric utilities from activities other than sale of electricity.

The Commission encourages NORECO II to improve its financial operation through the development of other related sources of revenue. In order to balance the interests of NORECO II and its end-users and in recognition of the fact that some of the costs incurred in rendering services under ORI had already been included in the revenue requirement, the Commission has adopted this policy. The ORI that arises from activities not related to the business of the cooperative nor involves the use of its assets will not be deducted from the revenue requirement of the cooperative. The ORI that arises out of related business activities or is asset based will be shared by the cooperative and the end-user by including 50% in revenue requirement.

The total non-asset based ORI which were not deducted from the total revenue requirement amounts to 13,107,640

The ORI subjected to the 50% rule was computed as follows:

Other Revenue Items

Prompt Payment Discount-NPC, net of Prompt Payment Discount given to customers	PhP	<u>899,850</u>
50% of the Above	PhP	<u>449,925</u>

The Commission rules that any interest/dividend income earned will be retained 100% by NORECO II. However, such income should form part of the reinvestment fund and will be used solely for rehabilitation / expansion programs of NORECO II.

II.A.6. DEBT SERVICE

The Commission made a downward adjustment of PhP 4,352,767 to assure that the debt service account included in NORECO II's revenue requirement is consistent with NEA's records. The Commission excluded the interest cost associated with Cash Working Capital in the amount of PhP 4,544,669 as calculated by NORECO II due to lack of justification. Thus, the total allowable amount for debt service in the determination of the revenue requirement should be PhP 14,356,928. The details of the adjustment are shown below.

LOANS	LOAN PROFILE		ADJUSTMENT (PhP)
	PER NORECO II (PhP)	PER NEA (PhP)	
Loan A – Original Loan	2,245,292	2,245,292	0
Loan B – Rural Electrification	1,268,644	1,268,644	0
Loan C	172,028	172,028	0
Loan D	418,196	418,196	0
Loan E-OD	2,940,166	2,935,824	(4,342)
Loan F	418,868	1,675,472	1,256,604
World Bank-ESL-A	4,016,021	4,021,796	5,775
World Bank-ESL-B	1,619,676	1,619,676	0
All Risk Insurance	1,066,135		(1,066,135)
Interest Cost of Cash Working Capital ³	4,544,669		(4,544,669)
TOTAL	18,709,695	14,356,928	(4,352,767)

Pursuant to Section 60 of R.A. 9136 and E.O. 119, savings realized by electric cooperatives (ECs) due to the assumption of certain loans by the Power Sector Assets and Liabilities Management Corporation (PSALM Corp.) shall be passed on to the ECs' end-users. NORECO II applied for a rate reduction under the Guidelines for the Implementation of the Reduction in Rates of the Electric Cooperatives Due to Condonation of Debts issued by the Commission on October 21, 2002, as amended on November 15, 2002.

The Commission in its Order on this matter dated March 17, 2003, granted NORECO II a Provisional Authority to reduce its rates by PhP 0.0348/kWh effective on the next billing cycle after receipt of the said Order. The said reduction in rates is likewise shown on the rate schedule provided in the Disposition of this Decision.

³ Interest cost of cash working capital includes NORECO II's interest on short term loans from Metro Bank and RCBC.

II.A.7. REINVESTMENT FUND

The Commission permits a reinvestment fund equivalent to 5% of a cooperative's Gross Revenue to finance expansion and rehabilitation/upgrading of its existing electric power system in accordance with the submitted System Rehabilitation/Upgrading and/or System Loss Reduction Plan. This resulted in a downward adjustment of Php 17,386,620 on the reinvestment fund account representing the excess over the 5% allowed by the Commission.

One of the main purposes of providing the 5% Reinvestment Fund is for the end-users of NORECO II to shoulder part of their increasing capitalization requirements, as outside sources of funding are getting scarce.

The Reinvestment Fund is authorized subject to the following conditions:

- a. This reinvestment fund shall not be used, even temporarily, for any purpose other than for those projects specified in the submitted plan;
- b. The amounts collected for the reinvestment fund, including interest income (as discussed in Section II.A.5.), shall be placed in a separate account and shall be disbursed in accordance with the plan submitted by NORECO II;

- c. NORECO II is further required to submit a progress report no later than one (1) year after the date of this Decision and every year thereafter using the format prescribed by the Commission. The progress report shall include detailed accounting itemizing total collections, the actual use of all disbursements, and actual current system losses.

Upon review of the progress report, the Commission may issue an order for NORECO II to appear and show cause why it should continue collection of the reinvestment fund; and

- d. NORECO II shall submit a new System Rehabilitation/Upgrading and/or System Loss Reduction Plan covering the period 2004 to 2008, no later than one (1) year after the date of this Decision using the format to be prescribed by the Commission.

II.A.8. REVENUE REQUIREMENT SUMMARY

The table provided below is a comparison of approved revenue requirement with that proposed by NORECO II:

ACCOUNT NAME		NORECO II PROPOSAL	ADJUSTMENT	ERC APPROVAL
Purchased Power	PhP	356,192,815	57,760,973	413,953,788
Payroll		42,716,554	269,709	42,986,263
Operating & Maintenance (less of PP & Payroll)		40,560,975	(3,183,578)	37,377,397
Debt Service Cost (plus Interest Cost of Cash Working Capital)		18,709,695	(4,352,767)	14,356,928
Reinvestment Fund ⁴		36,654,403	(17,386,620)	19,267,783
Other Revenue Items		0	(449,925)	(449,925)
Total Revenue Requirement	PhP	494,834,442	32,657,792	527,492,234

NORECO II proposed an OATA of PhP 0.3109/kWh using rates of year 2000. The OATA is a measurement tool based on the formula: (Total Revenue Requirement less Existing Revenue) divided by kWh sales. This measurement is not meant to refer to any specific customer class.

The Commission, after considering adjustments of PhP 32,657,792 approves a total revenue requirement of PhP 527,492,234 based on the year 2000 equivalent to an OATA of PhP 0.0492/kWh for NORECO II. The difference in the computation of OATA between NORECO II and the Commission is primarily due to the power cost component of the existing revenue. NORECO II's OATA is based on existing approved power and distribution rates plus the average Purchased Power Adjustment (PPA) for the year. The approved OATA was computed using existing approved distribution rates (inclusive of WAC, if any) and unbundled power cost as of December 2003. The actual impact to end-users will depend on the level of

⁴ This item is reflected in the UFR as "Plus Percentage for Cooperative Investment".

rates currently being charged. This impact is illustrated in Sec. II.B.6. of this Decision.

II.B. RATE STRUCTURE/DESIGN DETERMINATION

II.B.1. FUNCTIONALIZATION, CLASSIFICATION and ALLOCATION

The functionalization and allocation factors used by NORECO II were the default factors provided for in the UFR issued by the Commission on October 30, 2001. In the case of NORECO II, a number of the default factors were found not to represent the best alternative among possible factors. Thus, the following three (3) default factors used by NORECO II for functionalization and allocation were modified, to wit:

First, the use of Net Plant in Service (PLTSVC-N) as a factor to functionalize and allocate Maintenance for Office and General Plant will cause skewed results by allocating these maintenance costs toward assets not part of such activity. The Commission, therefore, adopted a factor based on Net General Plant (GP-N) as a more reasonable method to allocate maintenance expense associated with general plant.

Second, the factor "Total Operation and Maintenance, Net of Fuel and Purchased Power" (TOMXFP), which was used as a default factor to functionalize costs under outside services, was replaced with the factor "Total

Payroll Excluding Administrative and General Payroll” (PAYXAG) in order to remove the possibility of allocating a portion of outside services costs to the transmission function.

Third, since the Commission is now including Other Revenue Items (ORI) not included by NORECO II in the calculation of its revenue requirement, it was necessary to functionalize and allocate these amounts. The functionalization factors for the ORI, which were determined based on direct assignment were, as follows:

Factor Name	Functionalization Factor Description	Total Check	Generation	Transmission	Distribution	Supply	Metering
ORI	Other Revenue Items	1.0000	0.0000	0.0000	1.0000	0.0000	0.0000

NORECO II submitted a classification of distribution costs into demand- and customer-related cost using the Minimum-Plant Method. This method resulted in a 46%-54% allocation on the average.

II.B.2. DESIGN AND CALCULATION OF CHARGES

II.B.2.a. BAPA

The Commission, in the design and calculation of charges takes note of the existence of the Barangay Power Associations (BAPAs) that were conceptualized by the National Electrification Administration (NEA) for the purpose of strengthening member awareness and involvement in efforts

towards the reduction of system loss, improvement of collection efficiency and fortification of the Institutional consciousness in the grassroots level.

The creation of BAPAs was also necessitated by the growing number of cooperatives' membership which made it impossible for the cooperatives to physically reach out to all end-users.

The cooperatives are responsible for the energization of the BAPAs while the latter is responsible for the maintenance of the electric lines and other installed equipment, the reading of meters and billing of power bills of respective member end-users. The cooperatives in this regard are mandated to grant various incentives to BAPAs such as three percent (3%) prompt payment discount, rebates on kWh sold, system loss allowance, honorarium for working BAPA officers, annual cash rewards for outstanding BAPAs and livelihood projects.

The Commission further acknowledges that cooperatives which have instituted BAPAs in their respective franchise areas incur costs with respect to the generation and distribution of power. With reference to the supply and metering functions, the cooperatives generally sustain minimal costs because they only read and bill the BAPAs' mother meters.

In the design and calculation of charges, the Commission did not consider the BAPA as a customer class.

II.B.2.b. GENERATION CHARGE

Consistent with the Commission's Orders dated September 29, 2003, Case No. 2003-291 [In the Matter of the Application for the Approval of the Revised Unbundled Generation Tariffs], and December 4, 2003, Case No. 2003-498 [In the Matter of the Adoption of the Incremental Currency Exchange Rate Adjustment (ICERA)], the revised generation charge to be billed to end-users shall be the approved rate per kilowatt-hour including Benefits to Host Communities, and the ICERA rate of PhP (0.0065)/kWh which will be implemented by NPC and PSALM within a period of six months starting December 2003 to May 2004.

For the Visayas Grid, the LRAC rates for the following billing cycles are as follows:

Billing Cycle	Visayas Grid PhP/kWh	Franchise & Benefits to Host Communities	FPCA PhP/kWh
Sept. 26, 2003 to Dec. 25, 2003	2.5752	0.0177	0.05
Dec. 26, 2003 to Mar. 25, 2004	2.6587	0.0177	0.05
March 26, 2004 to June 25, 2004	2.7421	0.0177	0.05
June 26, 2004 to Sept. 25, 2004	2.8255	0.0177	0.05

The implementation of NPC's Generation Rate Adjustment Mechanism (GRAM) and FOREX in the Luzon, Visayas and Panay/Bohol is terminated upon the effectivity of the approved rates based on the LRAC Methodology, as discussed in Section II.A.2. of this Decision. Moreover, the approved generation

rate will remain fixed until changes are authorized by the Commission pursuant to the afore-stated Order dated September 29, 2003. This allows NORECO II's Generation Charge to remain fixed until such time that NPC's approved rates are adjusted. This eliminates the need for future Purchased Power Adjustment (PPA).

II.B.2.c. TRANSMISSION CHARGE

The Commission's Decision in ERC Case No. 2001-901 dated June 26, 2002 and Order dated September 20, 2002 set the transmission charges for the TRANSCO without automatic adjustments. Since the transmission rates to be paid by NORECO II are fixed, it is the decision of the Commission to likewise fix the unbundled transmission rates billed to end-users.

The transmission charges approved for billing by NORECO II have been calculated based on the approved TRANSCO rates which include cross subsidy elements to be phased out over a three-year period. The following transmission charges will apply to all end-users consistent with the gradual phase-out of the intra-grid cross-subsidies:

	Residential	Commercial	Industrial	Public Buildings	Street Lights	Irrigation/ Water Sys.	High Voltage
October 2003– September 2004							
Demand Charge (PhP/kW)			14.52				14.52
Transmission System Charge (PhP/kWh)	0.6890	0.8972	1.4834	1.1898	0.8227	0.5710	0.9807
October 2004– September 2005							
Demand Charge (PhP/kW)			14.52				14.52
Transmission System Charge (PhP/kWh)	0.6919	0.9010	1.4901	1.1948	0.8262	0.5735	0.9852
October 2005– September 2006							
Demand Charge (PhP/kW)			14.52				14.52
Transmission System Charge (PhP/kWh)	0.6948	0.9048	1.4967	1.1998	0.8296	0.5758	0.9894

The Commission utilized the Coincident Peak Allocation Method on the transmission costs, considering that it yielded the most reasonable result for NORECO II's end-users.

II.B.2.d. SYSTEM LOSS CHARGE

The Commission defines system loss for utilities to include technical loss, non-technical loss and administrative loss or the utility's use of power for its own operations.

The Commission approves the recovery of allowed system loss through the establishment of a separate System Loss Charge in the bill to end-users. The System Loss Charge shall vary from one customer class to another depending on their respective contributions to the system loss. However, due to

limited information, the Commission is constrained to adopt a uniform System Loss Charge for all end-users of NORECO II.

The allowed system loss is equal to the average system loss for the years 2000, 2001 and 2002 or the system loss cap, whichever is lower. In arriving at this decision, the Commission recognizes that the distribution utility faces some risks of over- or under-recovery in the event its load characteristics change through time. The system loss not only results in additional unbundled generation costs but also additional unbundled transmission costs to be paid by end-users. When system loss is within the allowable caps, the distribution utility shall recover from the end-users all generation and transmission costs. Thus, system loss in excess of the allowable cap shall not be recovered from the end-users.

On December 8, 1994, Republic Act No. 7832, otherwise known as the Anti-Pilferage Law, was enacted. In July 1995, the ERB promulgated the Implementing Rules and Regulations (IRR) under ERB Case No. 95-05, to implement said law. Section 10 of R.A. 7832 and Rule IX, Section 1 of its IRR provide that the recoverable system loss should not exceed the fourteen percent (14%) ceiling allowed for year 2000.

The Commission believes that the present cap on Technical and Non-Technical System Loss of 14% should be used in the calculation of revenue requirements at this time. This would, however, be subject to change upon the

approval of a new policy by the Commission. The average Technical and Non-Technical System Loss or cap of 14% plus 1% cooperative own use (which should not include personal consumption of NORECO II's Board of Directors, officers and staff, whichever is lower shall be deducted from total power cost and to be billed separately as System Loss Charge.

The Commission found that NORECO II's 2000 to 2002 average system loss (excluding cooperative's own use) was 13.9972% which was lower than the aforementioned cap of 14%. Hence, the Commission considered the 2000 to 2002 average system loss of 14.1652% as a reasonable compromise to balance the interests of both NORECO II and its end-users. This would, however, be subject to change upon the approval of a new policy relative thereto by the Commission.

II.B.2.e. DISTRIBUTION CHARGE

The distribution charge shall be billed on a fixed rate per kilowatt-hour for all end-users. For end-users with demand meters, the distribution charge shall be billed using a combination of a fixed rate per kilowatt (kW) and fixed rate per kilowatt-hour (kWh).

NORECO II did not propose for distribution wheeling rates. However, the Commission believes that wheeling rates are parallel to the cost of service functionalized under Distribution. Thus, the Commission orders that the

Distribution Charge provided on Rate Schedules be likewise utilized as Distribution Wheeling Charges available to the future contestable market. However, other distribution utilities requesting to wheel power across NORECO II's facilities shall pay wheeling charges equivalent to Distribution Wheeling Charges for Industrial customers.

The Commission's decision to allow a distribution utility to avail of the Distribution Wheeling Charges of another distribution utility is based on the general intent of R.A. 9136 to promote a competitive generation market. Distribution utilities that currently or in the future shall rely in full or in part on the distribution facilities of another distribution utility should not be held captive by the other distribution utility in the purchase of unbundled generation. Therefore, distribution utilities are prohibited from bundling or tying the sale of generated or purchased power with the sale of unbundled distribution wheeling service.

II.B.2.f. METERING and SUPPLY CHARGES

The Commission acknowledges that cost-causation rate design principle suggests the recovery of customer-related costs associated with the metering and supply functions through fixed monthly charges. Along with this cost of service principle, however, the Commission also considers rate design impacts across the spectrum of end-users within each rate class. Although R.A. 9136 requires the removal of inter-class cross subsidies, the law does not require

removal of revenue flows that may be characterized as intra-class cross subsidies. The Commission has the flexibility to consider other factors in determining rate design for a particular class of end-users. Therefore, to mitigate the impact on below-average consumption of residential end-users, the Commission orders NORECO II to use a PhP 5.00 per customer per month and PhP 0.1527 per kWh rate for the metering function and orders NORECO II to use a PhP per kWh rate for the supply function. Street light end-users shall be billed with a fixed monthly customer charge for the supply function and no charge for the metering function.

All BAPA residential end-users will be charged with rates used for the Residential Class. The revenue that will be generated from the Supply and Metering Charges for BAPA end-users will comprise the fund from which NORECO II will draw various incentives it provides the same.

II.B.3. INTER-CLASS CROSS SUBSIDY

II.B.3.a. CROSS SUBSIDY RATE CALCULATION

The inter-class cross subsidies in existing rates are as follows:

	Total	Residential	Commercial	Industrial	Public Buildings	Street Lights	Irrigation/ Water Sys.	High Voltage
New Cost-Based Rev. Requirement (PhP)	527,492,234	279,784,678	130,223,730	17,495,520	29,854,922	10,011,515	9,703,545	50,418,324
Existing Rates Revenue (PhP)	522,575,181	259,167,437	140,943,479	15,632,379	30,266,838	11,116,579	11,898,688	53,549,781
Total Change in Revenue (PhP)	4,917,053	20,617,241	(10,719,749)	1,863,141	(411,916)	(1,105,064)	(2,195,143)	(3,131,457)
Percentage Change In Revenue	0.94%							
Normalized Existing Revenue (PhP)	527,492,234	261,606,014	142,269,655	15,779,469	30,551,627	11,221,178	12,010,646	54,053,645
Inter-Class Cross Subsidy Amts.(PhP)		(18,178,664)	12,045,925	(1,716,051)	696,705	1,209,663	2,307,101	3,635,321
Class Billing Determinants (in kWh)	99,936,469	49,651,127	26,745,663	3,014,033	5,743,484	2,150,305	2,301,590	10,330,267
Inter-Class Cross Subsidy Rates (PhP/kWh)		(0.3661)	0.4504	(0.5694)	0.1213	0.5626	1.0024	0.3519

II.B.3.b. CROSS SUBSIDY REMOVAL

Section 74 of R.A. 9136 and Rule 16, Section 5 of its Implementing Rules and Regulations provide that the ERC shall issue a scheme for phasing out all cross subsidies including subsidies within Grids, between Grids, and between classes of end-users. The phasing-out period shall not exceed three (3) years from the establishment of the Universal Charge, which may be extended for a maximum period of one (1) year subject to certain conditions.

The Commission approved the cross subsidy removal scheme for the TRANSCO in its Decision dated June 26, 2002, Case No. 2001-901, which impacts the unbundled transmission rates for NORECO II's end-users. This impact is reflected in the three-year schedule for unbundled transmission charges provided in Section II.B.2.c. above.

In the instant case, the Commission will order the cross subsidy removal process at a later date following the establishment of the Universal Charge. Until such time, NORECO II will continue to charge the inter-class cross subsidy rates set forth in Section II.B.3.a. above.

II.B.4. LIFELINE RATE and LEVEL

Section 4 (hh) of R.A. 9136 defines Lifeline Rate as the subsidized rate given to low-income captive market end-users who cannot afford to pay at full cost. Pursuant to Section 73 of R.A. 9136, the Commission hereby sets the level of lifeline consumption and its corresponding discount rates.

In determining the lifeline level of consumption to be provided to the marginalized end-users, the Commission calculated the probable load requirement of typical low-income end-users by considering two (2) lighting facilities at 20 watts each and a 50-watt Radio that are being used for a reasonable number of hours. Thus, the Commission sets the lifeline consumption maximum level of 20 kWh for NORECO II. The Commission considers the impact that the subsidized Lifeline Rates will have on other end-users who must carry the costs associated with such subsidy. This fact, combined with the desire to maximize the benefit to as many marginalized end-users as possible, has led the Commission to adopt the following graduated scale for lifeline discount for NORECO II. The graduated scale is also based on

the recognition that individual end-user consumption may likely vary from month to month.

15 kWh and below	-	50%
16 kWh	-	40%
17 kWh	-	30%
18 kWh	-	20%
19 kWh	-	10%
20 kWh	-	5%

NORECO II shall apply these discounts to the following residential charges: Generation, Transmission, Distribution, Supply, Metering, and System Loss. In a given billing period, an end-user at any of the above consumption levels shall be given the specified corresponding discount on each of these rate components. An end-user with a level of consumption exceeding 20 kWh in a particular billing period shall not be entitled to any discounted lifeline rate for said period.

The cost of subsidy to lifeline end-users shall be passed on to all non-lifeline end-users. For NORECO II, the lifeline discounts result in a Lifeline Rate Subsidy by other end-users equal to PhP 0.0692/kWh.

The Commission believes that BAPA's marginalized residential end-users should likewise enjoy the benefit of lifeline rates. For this purpose, NORECO II's BAPAs that comprise of residential and commercial end-users

were appropriately integrated into the different customer classes in which they belong.

NORECO II shall coordinate with its Barangay Power Associations to gather information on the number of kWh falling under the different lifeline levels and corresponding discount rates for proper billing and implementation of lifeline benefits on the same. Each association will accordingly implement/provide lifeline benefits to its deserving BAPA end-users.

II.B.5. OTHER CHARGES

NORECO II's additional submissions to this Commission of its existing Other Charges as previously presented were considered in the determination of its revenue requirement. Fifty percent (50%) of the revenues derived from these charges were appropriately deducted from the determination of the revenue requirement allowed to NORECO II. In future cases filed after Other Charges have been established based on cost, the appropriate level of deduction of the revenue derived from these charges may be revisited.

The Other Charges of NORECO II are hereby pegged at their existing levels until such time that the Commission sets new rates on the same. Further, NORECO II is ordered to make a compliance filing on its Other Charges one (1)

year from the date of this Decision using a format to be prescribed by the Commission.

The compliance filing for approval of Other Charges shall include rates that are cost-based, as well as all supporting cost justifications for the rates, including but shall not be limited to the amount of actual time and wages of employees performing each task encompassed by each type of Other Charges.

II.B.6. ESTIMATED IMPACT ON AVERAGE RESIDENTIAL CONSUMER

A comparison of the estimated impact of all adjustments to the revenue requirement on the monthly bill of an average residential end-user consuming 80 kWh a month, using rates based on NORECO II's actual existing rates as of December 2003 against the unbundled rates approved by the Commission, is shown below:

BASED ON ACTUAL EXISTING RATES			BASED ON ERC APPROVED UNBUNDLED RATES		
	PhP/kWh	Amount (PhP)		PhP/kWh	Amount (PhP)
Basic Rate	3.3809	270.47	Generation Charges:		
			Generation System Charge	2.6587	212.70
PPA	1.5298	122.38	Benefits to Host Comm. Charge	0.0177	1.42
			FPCA Adjustment Charge	0.0500	4.00
			ICERA	(0.0065)	(0.52)
Power Act Rate Reduction*	(0.3456)	(27.65)	Transmission System Charge	0.6890	55.12
			System Loss Charge	0.5867	46.94
Rate Reduction Due to			Distribution Charge	1.0119	80.95
Loan Condonation	(0.0348)	(2.78)	Supply Charge	0.4013	32.10
			Metering Charges:		
			Retail Meter Charge/Month		5.00
Universal Charges:			Metering System Charge	0.1527	12.22
Missionary Elect. Charge	0.0373	2.98	Universal Charges:		
Environmental Charge	0.0025	0.20	Missionary Electrification Charge	0.0373	2.98
			Environmental Change	0.0025	0.20
			Inter-class Cross Subsidy Charge	(0.3661)	(29.29)
			Rate Reduction Due to Loan Condonation	(0.0348)	(2.78)
			Lifeline Rate (Discount)/Charge	0.0692	5.54
			Power Act Rate Reduction*	(0.3456)	(27.65)
TOTAL BILL		365.60	TOTAL BILL		398.93
PhP/kWh		4.5700	PhP/kWh		4.9866
* Inclusive of previous month's adjustment.					

DISPOSITION

WHEREFORE, the foregoing premises considered, it is hereby decided as follows:

- To approve the unbundled schedule of rates of NORECO II to be effective on the first billing cycle thirty (30) days after receipt of this Decision:

		Res.	Comm.	Ind'l.	Pub. Bldgs.	St. Lights	Irrig./ Water System	High Voltage
Generation Charges:								
Generation System Charge	PhP/kWh	2.6587	2.6587	2.6587	2.6587	2.6587	2.6587	2.6587
Benefits to Host Comm. Charge	PhP/kWh	0.0177	0.0177	0.0177	0.0177	0.0177	0.0177	0.0177
FPCA Adjustment Charge	PhP/kWh	0.0500	0.0500	0.0500	0.0500	0.0500	0.0500	0.0500
ICERA	PhP/kWh	(0.0065)	(0.0065)	(0.0065)	(0.0065)	(0.0065)	(0.0065)	(0.0065)
Transmission Charges:								
Demand Charge	PhP/kW			14.52				14.52
Trans. System Charge	PhP/kWh	0.6890	0.8972	1.4834	1.1898	0.8227	0.5710	0.9807
System Loss Charge	PhP/kWh	0.5867	0.5867	0.5867	0.5867	0.5867	0.5867	0.5867
Distribution Charges:								
Demand Charge	PhP/kW			14.52				14.52
Dist. System Charge	PhP/kWh	1.0119	0.5426	0.8072	0.6389	0.4531	0.3119	0.4744
Supply Charges:								
Retail Customer Charge	PhP/Cust./Mo.		23.42	23.24	23.24	49.06	23.24	23.24
Supply System Charge	PhP/kWh	0.4013						
Metering Charges:								
Retail Meter Charge	PhP/Meter/Mo.	5.00	19.63	73.36	29.03		114.07	1,134.40
Metering System Charge	PhP/kWh	0.1527						
Inter-class Cross Subsidy Charge:	PhP/kWh	(0.3661)	0.4504	(0.5694)	0.1213	0.5626	1.0024	0.3519
Rate Reduction Due to Loan Condonation	PhP/kWh	(0.0348)	(0.0348)	(0.0348)	(0.0348)	(0.0348)	(0.0348)	(0.0348)
Universal Charge:								
Missionary Electrification Charge	PhP/kWh	0.0373	0.0373	0.0373	0.0373	0.0373	0.0373	0.0373
Environmental Charge	PhP/kWh	0.0025	0.0025	0.0025	0.0025	0.0025	0.0025	0.0025
Lifeline Rate (Discount)/Charge	PhP/kWh	0.0692	0.0692	0.0692	0.0692	0.0692	0.0692	0.0692
Power Act Rate Reduction	PhP/kWh	(0.3000)						
Lifeline Rate (Discount)/Subsidy To be based on Residential Rate in a Graduated Scale as provided in Sec. II.B.4. of this Decision.								
Rate Reduction Due to Loan Condonation per ERC Order dated March 17, 2003 in Case No. 2003 – 94.								
Transmission Charges shall be changed as described in Section II.B.2.c. of this Decision.								

2. To direct NORECO II to comply with the following:
 - a. Discontinue charging the PPA upon effectivity of the approved unbundled rates; NORECO II shall automatically bill its end-users the new Generation Rate charged by NPC as approved and authorized by the Commission;
 - b. Bill PhP 0.0373/kWh representing the missionary electrification portion of the Universal Charge in accordance with the Decision of the Commission in ERC Case No. 2002-165 (In the Matter of the Petition for the Availment from the Universal Charge the Share for Missionary Electrification, NPC, Applicant);
 - c. Bill PhP 0.0025/kWh representing the environmental portion of the Universal Charge in accordance with the Decision of the Commission in ERC Case No. 2002-194 (In the Matter of the petition for the Availment from the Universal Charge the Environmental Share/Charge for the Rehabilitation and Management of Watershed Areas, NPC, Applicant);
 - d. Bill its respective end-users using a billing format which contains at least the rate elements provided in Annex A of this Decision upon effectivity of the approved unbundled

rates. The rate elements provided in Annex "A" should appear on the end-users bill even if the rate elements currently have a value of zero or have not yet been determined by the Commission;

- e. Inform the end-users within its franchise area of the approved unbundled rates not later than thirty (30) days after receipt of this Decision;
- f. Submit for verification and confirmation purposes on or before the twentieth (20th) day of the month following the effectivity of the approved unbundled rates and every month thereafter: a) five (5) sample bills for each end-user class; b) copy of the bills from the generation and transmission companies; and c) Monthly Financial and Statistical Reports (MFSRs), complete with all related schedules;
- g. Make a formal application with the Commission for the approval of existing or future contracts with any entity for the wholesale purchases of power not yet approved by the Commission;

- h. Make a formal application to continue the use of Other Charges within one (1) year from date of this Decision using a format to be prescribed by the Commission;
- i. File a progress report on the reinvestment fund no later than one (1) year after the date of this Decision and every year thereafter using the prescribed formats provided in Annexes B and C of this Decision. The report shall include detailed accounting of actual collections and deposits, specific transactions and withdrawals for all disbursements, and actual current system losses;
- j. Submit a new System Rehabilitation/Upgrading and/or System Loss Reduction Plan covering the period 2004 to 2008, no later than one (1) year after the date of this Decision using the format to be prescribed by the Commission; and
- k. Institute policies and procedures for cost-cutting and transparent and competitive procurement of goods and services and submit a report thereon to the Commission within six (6) months from receipt of this Decision.

SO ORDERED.

Pasig City, December 29, 2003.

MANUEL R. SANCHEZ
Chairman

OLIVER B. BUTALID
Commissioner

CARLOS R. ALINDADA
Commissioner

LETICIA V. IBAY
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