



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

Visayan Electric Company (VECO)

ADDENDUM

Prepared

by the

ENERGY REGULATORY COMMISSION

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APPENDIX A: SUMMARY OF COMMENTS

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 procedures 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.

VECO submitted its PBR revenue application to ERC on June 15, 2009³ (Revenue Application). The Commission issued its report on its review of the OPEX forecasts included in VECO'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 Cebu City on January 15, 2010. At the public consultation, VECO 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 was present at the public consultation and have now reviewed the additional information supplied by VECO insofar as this information relates to OPEX forecasts. 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 Forecast: Second Regulatory Period on VECO's reasonable OPEX requirements for the second regulatory period.

The issues that were discussed at the public consultation are summarized in Appendix A. Only those issues that could have a material impact on the OPEX approved in the Draft Determination 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 2009-040RC.

⁴ *Review of Operating and Maintenance Expenditure (OPEX) Forecast: Second Regulatory Period, Visayan Electric Company (VECO)*, ERC, October 19, 2009.

⁵ *Regulatory Reset for Visayan Electric Company (VECO) 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 forecasts allowed in the Draft Determination considering the approved adjustments on the CAPEX forecasts and updated data for the CPI.

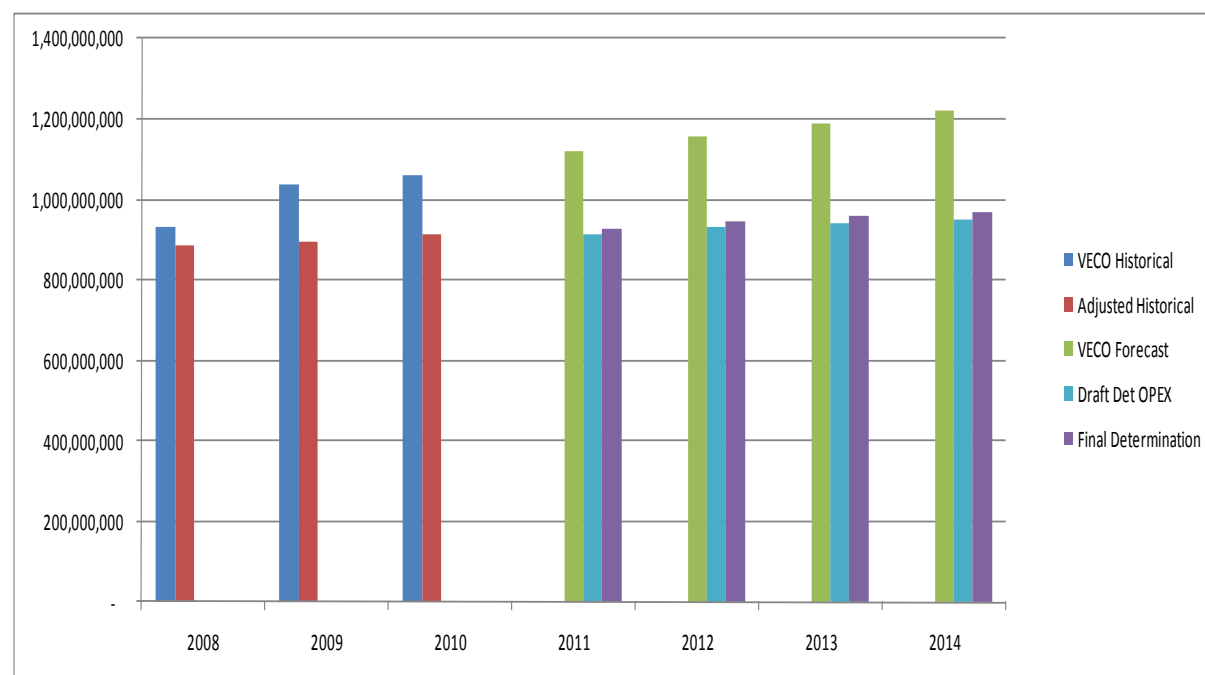
Operating and Maintenance Expenditure Forecasts (PhP million, real 2009)

	RY 2010	RY 2011	RY 2012	RY 2013	RY 2014	Total ¹
Draft Determination	895.32	912.03	930.19	941.55	951.11	4,630.20
Adjustments to <i>Distribution Operating and Maintenance</i>	-0.03	-0.03	-0.03	-0.15	-0.21	-0.47
Adjustments to <i>Administrative and General</i>	17.16	17.21	17.27	17.28	17.28	86.20
Adjustments to Regulated Retail Services	0.06	0.07	0.06	0.06	0.06	0.30
Total Adjustments	17.19	17.25	17.28	17.19	17.13	86.03
Revised OPEX Forecasts	912.51	929.28	947.47	958.74	968.24	4,716.23

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

The adjustments to Distribution Operating and Maintenance and Administrative and General cover additional capital expenditure on the line items for the provision of laboratory test equipment, replacement of vehicles, adjustment on the consumer consumption metering, refurbishment of existing buildings and the purchase of new works and asset management system. This results to a net reduction in Distribution Operation and Maintenance forecasts considering that the increases in the capital expenditures over the second regulatory period relate to renewal and refurbishment, which are considered to replace existing assets at or near the end of their service lives and therefore reduce the OPEX required to maintain these assets. This is, however, compensated by increases resulting from the updated CPI data as of February 2010 as published by the EIU.

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



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

3. OPERATING AND MAINTENANCE EXPENDITURE

3.1 EMPLOYEE PENSION AND BENEFITS (APPENDIX A – ITEM 2)

3.1.1 Background

In its comments on the Draft Determination, VECO proposed that the following non-monetary benefits paid in 2008 be included as part of the efficient base expenditure: medical benefits - PhP7.5 million; health insurance - PhP2.2 million; meal allowance - PhP3.8 million; and, rice subsidy - PhP7.9 million.

3.1.2 Analysis

ERC made adjustments to its original recommendation to allow for rice subsidy and uniform allowance as reasonable costs to be provided to its employees determined to be necessary for the conduct of its operations. It has been the Commission's policy that additional benefits provided to the Regulated Entities' employees should be sourced from their savings and not passed on to its customers. However, this does not preclude them to provide additional incentives or benefits to their employees provided that the associated cost or expenses are not passed on to their customers..

3.2 BAD DEBTS (APPENDIX A – ITEM 3)

3.2.1 Background

In its comments on the Draft Determination, VECO proposed reasonable uncollectible accounts should be equal to the last 5 years' average of actual accounts receivable written-off.

In the Draft Determination, the Commission has been consistent with its policy reflected in all its decisions that the allowed provision for bad debts should be the lowest of the actual accounts written-off for the test year; or the last 5 years' average of accounts written-off; or 1% of outstanding trade accounts receivable for the test year.

3.2.2 Analysis

Following the Commission's policy, ERC determined that the amount equal to 1% of VECO's outstanding trade accounts receivable for CY2009 is the lowest. The Commission allowed PhP7.7 million of bad debts in the base year. ERC, therefore, has no changes to the bad debts allowed in the Draft Determination.

3.3 OPEX REVIEW METHODOLOGY AND ASSUMPTIONS (APPENDIX A - ITEM 4)

3.3.1 Background

In its Revenue Application VECO indicated its forecasting methodology to justify its OPEX forecast. In the OPEX Review Report, ERC indicated that it used the OPEX forecasting model in order to assess the reasonableness of the VECO OPEX forecast.

In its comments on the Draft Determination, VECO sought clarification on the Commission's basis for the additional adjustments amounting to PhP432 million.

3.3.2 Analysis

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. The base year OPEX submitted by VECO was PhP931.84 million (real 2009). Adjustments on its employee pension and benefits, information technology system operations, representation expenses as well as bad debts

expense were made to the base year cost of the model, considering that VECO proposed relatively high 2008 base year retail costs per customer.

The adjustments made for each line item, as provided in the OPEX Review Report, are accounted for by the cost drivers used reflecting the impact of efficiency initiatives by providing reasonable expenditures. This will further be shown in the OPEX model which will be provided as part of the Final Determination.

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 cost is aligned with the number of staff. The total OPEX is also affected by the prices in materials and labour costs.

The resulting adjustments from VECO's OPEX forecasts would account for the difference in the OPEX forecasts generated by the model and VECO's proposal.

In consideration of the approved adjustments on the CAPEX forecasts, ERC identified corresponding adjustments to the OPEX forecasts in the Draft Determination, specifically on Distribution Operating and Maintenance and Administrative and General Expenditures, as follows:

Table 1: 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	343.67	354.25	364.48	368.29	370.38	1,801.07
Adjusted OPEX Model	343.63	354.22	364.44	368.14	370.17	1,800.60
Difference	-0.04	-0.03	-0.04	-0.15	-0.21	-0.47
Administrative and General						
Draft Determination	249.89	250.70	251.47	251.77	251.94	1,255.78
Adjusted OPEX Model	267.05	267.92	268.73	269.05	269.22	1,341.97
Difference	17.16	17.22	17.26	17.28	17.28	86.19
Regulated Retail Services						
Draft Determination	301.77	307.08	314.24	321.48	328.79	1573.35
Adjusted OPEX Model	301.83	307.14	314.30	321.55	328.85	1573.66
Difference	0.06	0.06	0.06	0.07	0.06	0.31
Total Operating and Maintenance Expenditure						
Draft Determination	895.32	912.03	930.19	941.55	951.11	4,630.20
Adjusted OPEX Model	912.51	929.28	947.47	958.74	968.24	4,716.23
Difference	17.19	17.25	17.28	17.19	17.13	86.03
OPEX Adjustments	17.19	17.25	17.28	17.19	17.13	86.03

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

Changes in the OPEX are brought about by changes in the CAPEX forecast and the increase in the Consumer Price Index (using February 2010 data as published by the Economist Intelligence Unit). The slight decrease in the OPEX forecast relating to Distribution Operation and Maintenance is due to the upward adjustments on Renewal and Refurbishment CAPEX Projects which, as previously indicated, tend to correspondingly decrease OPEX.

3.4 ADDITIONAL OPEX (APPENDIX A - ITEM 5)

3.4.1 Background

In its comments on the Draft Determination, VECO pointed out that the 138kV project that is subject to the DENR requirement consists of: 1) the construction of the 138kV Naga substation, and 2) the stringing of the 37-kM 138kV tie line between the new CEDC power station in Toledo and the 138kV Naga substation. Although the substation was recommended for deletion, the tie line was recommended to proceed. Considering the distance covered by the tie line, VECO claims that the DENR requirement is mainly due to this component of the 138kV project.

In this regard, VECO proposed for an additional operating forecast cost amounting to PhP50 million, incidental to the tree planting activity in compliance with the DENR requirement, for VECO's proposed 138kV capital project. This will be recovered over a period of 3 years from 2011 to 2013 at PhP16.67 million per year.

3.4.2 Analysis

As per Section 2.7 of the GBA CAPEX Report Addendum, GBA clarified its recommendations that the 138kV substation project will not proceed including the 138kV tie line between NGCP's Naga substation and its proposed 138/69kV Colon substation.

In this regard, ERC has no "additional" OPEX for the Final Determination.

4. TAXES, LEVIES AND DUTIES

4.1 REAL PROPERTY TAXES (APPENDIX A - ITEMS 7 & 8)

4.1.1 Background

VECO included real property taxes in its forecast taxes, levies and duties forecast in its Revenue Application. In the Expenditure Report, we recommended that these be adjusted down to CY2008 value, as taxes for which VECO's liability has not been confirmed should not be included.

VECO sought clarification on the downward adjustments on real property taxes from CY2009 through the second regulatory period. VECO noted that the real property taxes paid in CY2009 has not been considered in its forecast for the second regulatory period.

4.1.2 Analysis

VECO stated that it had submitted capital expenditures related to these costs, which had not been taken into account in determining the OPEX forecasts. In 2009, the cost of land acquisitions for the NRA and Minglanilla substations is PhP41.41 million; in 2012, the cost of the lot for the Calamba substation is estimated at PhP15.95 million; and, in 2013, the cost of the Juan Luna substation lot is expected to be PhP27.34 million. Real property taxes on these new acquisitions would be 3% of the assessed value, which is computed at 10% of the acquisition cost. Therefore, additional real property taxes for the years 2009, 2012 and 2013 should be PhP124,218, PhP47,855, and PhP82,006, respectively.

As per GBA CAPEX Report, it was evaluated that the Minglanilla substation is not required until RY2011. VECO has not submitted proof evidence of its land acquisition in 2009 for the Minglanilla substation.

It has been the Commission's policy that uncertain tax liabilities should not form part of the forecast. In the event of the future imposition of additional taxes or should VECO become liable for taxes that are not included in the annual revenue requirement, Article XI of the RDWR allows for unexpected tax liabilities imposed during the Second Regulatory Period by means of a "Tax Event Pass Through". Considering that such proposed capital projects is non-existent, there is uncertainty to pay additional real property taxes, thus, ERC has no changes to the Taxes, Levies and Duties forecasts.

**APPENDIX A
SUMMARY OF COMMENTS**

No.	Page/ Section Number	VECO's Comments	VECO's Proposed Change (s)	ERC' Position
1	<u>OPEX</u>	<p>General Comment –</p> <p>VECO applied for a first year MAP of PhP1.2605 per kWh. This was subsequently reduced to PhP1.2096 per kWh due to adjustments in the revenue requirement as recommended by the Honorable Commission in its draft determination. Such difference will create distortions which will adversely affect the company's ability to operate efficiently. Comparing the reduced VECO MAP of Ph1.279/kWh against the latest approved MAPs of CEPALCO and MERALCO of Php1.448/kWh and Php1.492/kWh, respectively, VECO's applied rate is, on the average, Php0.25/kWh less than the two first entrant DUs.</p> <p>VECO believes that, by virtue of the inequity inherent in the diversity of the MAPs set for CEPALCO, MERALCO and VECO, economies of scale is hampered as VECO will be constrained to render distribution services at costs higher than those to be incurred by CEPALCO and MERALCO for the same level of distribution services. The impact of this inequity is staggering as VECO will definitely encounter difficulty in maintaining efficiency goals and in keeping at par with other distribution utilities. These issues will potentially, adversely affect other late entrants, as well, placing them at a direct disadvantage from the early entrants.</p> <p>On the basis of the PBR rules, VECO formulated its OPEX forecasts with a consideration of such various factors as reasonableness & efficiency, forecast growth of connections, energy delivery or coincident peak demand, sufficiency to maintain or improve existing service performance or the system's reliability levels,</p>		<p>A direct comparison between the distribution prices of DUs is not appropriate, especially in a single year. Annual price-levels are influenced by a variety of factors over and above the pure revenue-requirement, such as earlier under-recoveries, the level of the opening MAP for a regulatory period, the rate of increases forecast over the regulatory period, etc..</p> <p>In addition, a comparison with the overall forecast price-paths for the 2nd regulatory period (inflation adjusted) for Meralco and Cepalco indicates quite clearly that the proposed VECO price-path over the same regulatory period is higher on average, and also expected to end on a higher value.</p> <p>The approach adopted by the ERC, namely to establish an efficient base-year value from which forecast base OPEX is derived through trend analysis, is widely accepted and used internationally. Fluctuating, or special expenditure is considered over and above the base patterns, but only if sufficient justification is provided.</p> <p>The details of this are shown in the Final Determination document.</p>

No.	Page/ Section Number	VECO's Comments	VECO's Proposed Change (s)	ERC' Position
		<p>and reasonable allowance for forecast changes in CPI or exchange rate levels. To substantiate its forecasts, VECO submitted sufficient justifications in its application.</p> <p>The OPEX model's approach seemed to have disregarded the above by using a very simplistic approach in the evaluation of VECO's OPEX forecasts. A base year 2008 was utilized as a starting point and forecast peso figures were derived only using asset growth and CPI. Under such a process, it is not clear if the real cost drivers on a per-Regulatory Year basis have been considered in the review. There are numerous activity drivers which are unique and vary from one period to the next. Establishing the standards of efficiency and performance by simplistically using year 2008 figures alone plus CPI adjustment certainly is not the objective process envisioned under the PBR regime.</p>		
2	Page 32 / Section 5.6.1, Paragraph 3	<p>Employee pension and benefits – The grant of allowances is not unique to employment in VECO for it is a worldwide practice in human resource management to design compensation packages which include not only salaries, but allowances and other non-monetary benefits as well. In evaluating the value of employment in any company, it cannot be gainsaid that one's compensation package is a primary incentive for entering and staying with any employer. While VECO agrees that it is a management prerogative to provide benefits more than what present labor statutes mandate, VECO respectfully submits that its exercise of this prerogative is driven only by a need to maintain efficiency and reliability in the operation of</p>	The following non-monetary benefits paid in 2008 shall be included as part of the efficient base expenditure: medical benefits - PhP7.5 million; health insurance - PhP2.2 million; meal allowance - PhP3.8 million; and, rice subsidy - PhP7.9 million.	The treatment is consistent with the Commission's policy that additional benefits given to employees should be sourced from savings and not from the rates chargeable to consumers.

No.	Page/ Section Number	VECO's Comments	VECO's Proposed Change (s)	ERC' Position
		<p>its distribution system and in serving the requirements of its consumers. Towards this humble objective, VECO, at the expense of all stakeholders -- its owners and its customers alike – should not be bound to retain a manpower complement which, although resulting in low labor costs, only exhibits substandard skills and delivers unreliable output. Certainly, in an industry as specialized as electricity distribution, competence is an indispensable employee characteristic given the esoteric nature of the power business and its rapidly changing technological and legal landscape. The fact that non-regulated industries such as telecommunications and power generation require a similar competence does not help, as it raises the competitiveness among employers in the recruitment of highly-skilled individuals. For VECO, the stiffness of the competition is aggravated by the present fact that many of the employers in these non-regulated industries actually offer salaries and benefits more attractive than those of VECO employees, in the absence of the regulatory parameters within which VECO operates.</p> <p>The importance of having a competitive total package cannot be overemphasized. It must be pointed out that, despite its already relatively acceptable compensation package, VECO still lost a total of 26 employees including 16 linemen and engineers and 4 specially trained IT personnel in 2009, and another 20 employees have tendered their resignations effective January 2010. The loss of the cumulative knowledge and experience of these people cannot be quantified as it gravely affected service levels which can only be re-attained at such time when their replacements</p>		

No.	Page/ Section Number	VECO's Comments	VECO's Proposed Change (s)	ERC' Position
		<p>possess the same aggregate skills lost.</p> <p>Notwithstanding, VECO has always endeavored to provide for its employees such that its employment benefits are still considered within the industry to be competitive. In striving to keep its compensation scheme competitive, VECO is able to retain a competent workforce whose efficiency and effectiveness in the service of VECO consumers are not held back by a demoralizing and unsupportive VECO management.</p> <p>To illustrate, where VECO has no medical or insurance benefits in place for its employees, no lineman will be keen on performing jobs on live lines. Possibly, this will result to power interruptions at the expense of VECO consumers. Definitely, there is a positive nexus between the VECO employment benefits and the level of efficiency and reliability of the VECO distribution system. This correlation strongly justifies the recovery as allowable expenses of these employment benefits because they logically bring about outstanding employee performance and, concomitantly, outstanding consumer service. In disallowing the recovery of the cost of employment benefits, distribution utilities such as VECO, being in a heavily regulated industry, will be strongly discriminated against as an employer considering the disincentive to a distribution utility to offer competitive compensation and, resultantly, to attract and retain talent within its fold. Certainly, the Commission, in protecting the rights of consumers, should authorize neither oppression nor self-destruction of the distribution utility. It is well worthy of note that even the National Government, in exempting certain government agencies and government-owned</p>		

No.	Page/ Section Number	VECO's Comments	VECO's Proposed Change (s)	ERC' Position
		<p>and/or –controlled corporations from the Salary Standardization Law, recognizes the need to attract the best and brightest people to its ranks by formulating competitive compensation packages for its employees.</p> <p>With respect to the non-pecuniary nature of the employment benefits, it is the intention of VECO that the benefits be dedicated solely to the purpose for which they were granted (i.e. medical, meals). Thus, if VECO, for instance, simply distributes the monetary equivalent of medical benefits to its employees, the purpose of the benefit, which is medical assistance, may be defeated. This is especially true where the employee utilizes the monetary equivalent in another manner and has nothing to show for when in need of actual medical care. Being concretely a medical benefit, the employee readily appreciates the concern, which his employer has for his health so that employee morale is boosted. This is the “soft” part of the employee’s compensation package as it engages the employee emotionally. An emotionally engaged employee is a loyal and motivated employee, which leads to higher employee retention. Surely, this will redound to the benefit of the customer through better and consistent services performed by satisfied employees.</p> <p>To note, the Tax Code (<i>National Internal Revenue Code of 1997, as amended</i>) and its relevant implementing Revenue Regulations Nos. 2-98 and 3-98, as amended, actually recognize these types of benefits by way of exempting them from income tax up to a certain amount. Under this exemption, the employee enjoys the full peso impact of the benefit; this</p>		

No.	Page/ Section Number	VECO's Comments	VECO's Proposed Change (s)	ERC' Position
		<p>would not be true if the benefit was simply integrated into the salary of the employee. Thus, by the Commission disallowing the recovery of the value of these monetary benefits for rate-making purposes, distribution utilities such as VECO may move towards a compensation package consisting purely of the employee's salary, to the detriment of the employee who will never have the benefit of the application of the tax exemption.</p> <p>In all precedent rate cases, the Commission and its predecessor agency have recognized the foregoing employment benefits as recoverable. To presently disallow their recovery will run counter to the general practice of regulators in other countries which allow the recovery of the costs of employee benefits, provided that, they are not excessive.</p> <p>Verily, there is no cogent reason for the exclusion of employment benefits for recovery as both salary and non-salary benefits form part and parcel of the total compensation package of the employee and serve exactly the same purpose in the motivation of the employee.</p>		
3	Page 32 / Section 5.6.1, Last Paragraph	<p>Bad debts written-off by VECO were as follows: 2004 - PhP50.06 million, 2005 - none, 2006 - PhP60.07 million, 2007 - PhP79.32 million, and 2008 - PhP38.83 million or a total of PhP228.28 million for the 5 year period. This is an average of PhP45.66 million worth of bad debts written-off. For reference, attached are the Income Tax Returns for 2004, 2005, 2006, 2007 and 2008 (Annexes K, L, M, N and O). Based on historical data, VECO believes that the bad debts expense of PhP40.04 million is reasonable.</p> <p>VECO's base year 2008 operating and maintenance expenditure was PhP932.8 million, as shown on Table</p>	<p>To provide for reasonable uncollectible accounts equal to the last 5 years average of actual accounts receivable written-off.</p> <p>This paragraph should read as follows: "The resulting 2008 base year operating expenditures after the ERC recommended total adjustments amounting to PhP64.5 million are as shown in Table 5.2. This has been used in the OPEX model to</p>	<p>Bad debts allowed in the draft determination is consistent with the Commission's policy on bad debts.</p>

No.	Page/ Section Number	VECO's Comments	VECO's Proposed Change (s)	ERC' Position
		5.1, page 30 of the Draft Determination. With the adjusted base year 2008 operating and maintenance expenditure of PhP868.34 million, the total adjustments amounted to PhP64.47 million.	forecast future expenditures."	
4	Page 34 / Section 5.8.2	Deducting the base year adjustments, additional expenditures due to the tree planting requirement of the DENR, and the reduction in bad debts expense, the downward adjustments to the forecast regulatory years should be as follows: 2010 - PhP118.42 million, 2011 - PhP141.63 million, 2012 - PhP146.59 million, 2013 - PhP147.57 million, and 2014 - PhP132.29 million or a total adjustment of PhP686.50 million (please refer to Annex P). This is lower by PhP432.11 million against the recommended total adjustment of PhP1,118.61 million. We would like to be enlightened on the basis for the PhP432.11 million additional adjustments.		The additional adjustments amounting to PhP432.11 million refer to the forecast adjustments as a result of the impact of efficiency initiatives and cost drivers used to determine the forecast expenditure.
5	Page 37 / Section 5.11.2	The OPEX Model used to generate the OPEX forecasts over the modelling period from 2010 to 2014 did not take into account the additional operating expenditure forecast of PhP50 million that is incidental to the 138kV project in compliance with the tree planting requirement of the DENR. As discussed in the Operating and Maintenance Expenditure Review Report, the disallowance is due to the recommended deletion of the 138kV Naga substation. However, we would like to point out that the 138kV project that is subject to the DENR requirement consists of: 1) the construction of the 138kV Naga substation, and 2) the stringing of the 37-kM 138kV tie line between the new CEDC power station in Toledo and the 138kV Naga substation. Although the substation was recommended for deletion, the tie line was recommended to proceed. Considering the distance covered by the tie line, we believe that the DENR	To integrate into the OPEX Model the additional operating forecast cost amounting to PhP50 million, incidental to the tree planting activity in compliance with the DENR requirement, for VECO's proposed 138kV capital project. This will be recovered over a period of 3 years from 2011 to 2013 at PhP16.67 million per year.	ERC has no additional OPEX considering that the 138kV project including the tie line does not form part of the approved CAPEX forecasts.

No.	Page/ Section Number	VECO's Comments	VECO's Proposed Change (s)	ERC' Position
		requirement is mainly due to this component of the 138kV project.		
6	Page 38 / Section 5.11.4	Under Table 5.5 the real value of operating and maintenance expenditure for 2010 (in Thousand PhP) is PhP 895,325 while the nominal value is PhP908,655. This is equivalent to an inflation rate of only 1.5%; however, the Philippine CPI percent increase for 2010 accepted by the Honorable Commission is 3.4%, as presented in Table 2.4, page 13, of the Draft Determination. The lower inflation rate used to derive the 2010 nominal value results to lower nominal values for the succeeding regulatory years.	To apply the 3.4% ERC-accepted forecast increase in CPI to determine the nominal values of operating and maintenance expenditure for 2010 and beyond.	ERC clarifies that the values refer to regulatory years. RY 2010 ends on June 2010. To escalate the 2009 submitted real values to nominal ones for 2010, two quarters of escalation only was applied - this is to escalate values to the mid-value for RY2010, rather than the end-value.
7	Page 41 / Section 6.4.1, Second Paragraph	The forecast increase in real property tax is mainly due to the purchase of land for the new substations. In 2009, the cost of land acquisitions for the NRA and Minglanilla substations is PhP41.41 million; in 2012, the cost of the lot for the Calamba substation is estimated at PhP15.95 million; and, in 2013, the cost of the Juan Luna substation lot is expected to be PhP27.34 million. Real property taxes on these new acquisitions would be 3% of the assessed value, which is computed at 10% of the acquisition cost. Therefore, additional real property taxes for the years 2009, 2012 and 2013 should be PhP124,218, PhP47,855, and PhP82,006, respectively. Taking into consideration the real property taxes on the additional lot acquisitions, the provision for real property taxes, in real values, should be as follows: 2009 to 2011 - PhP2,103,941; 2012 - PhP2,151,796; and 2013 to 2014 - PhP2,233,801.	The downward adjustments on Real Property Tax under Table 6.3 should be as follows: 2009 - 0.93, 2010 - 0.79, 2011 - 0.79, 2012 - 1.18, 2013 - 1.81 and 2014 - 1.82.	ERC has no further changes on the forecast taxes, levies and duties considering that VECO has not provided proof of evidence showing additional land acquisitions in 2009.
8	Page 43 / Section 6.5.3, Table	The real values under Table 6.4 do not match the values under Table 6.3.	The values under Table 6.3 and Table 6.4 should be the same as these are both in real 2009 values.	ERC determined that the difference accounts for the rounding off figures and has been corrected in the final

No.	Page/ Section Number	VECO's Comments	VECO's Proposed Change (s)	ERC' Position
	6.4		Taking into consideration VECO's proposals, the real values under Table 6.4 should be as follows: 2010 - PhP2,853,354, 2011 - PhP28,983,784, 2012 - PhP4,939,282, 2013 - PhP4,981,403, and 2014 - PhP4,937,531.	determination.
