



**Davao Light & Power Co.**



HEAD OFFICE: Aboltiz Corporate Center, Gov. Manuel Cuenco Avenue, Cebu City, Philippines 6000 • Tel: (062) 231-2310 • Fax: (032) 231-2710

February 10, 2003

**Atty. MARINA C. BUGAYONG**

Director

Regulatory Operations Service

Energy Regulatory Commission

Dear Ms. Bugayong,

This is in reference to the Commission's Draft Guidelines on the Methodology for Setting Transmission Wheeling Rates for 2003 to 2007, which is subject for consultation on February 19 to 21, 2003.

Please find attached comments for discussion.

Very truly yours,

  
**JUAN ANTONIO E. BERNAD**  
Senior Vice President

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The ERC is proposing a Transmission Wheeling rate based on Performance Based Regulation (PBR). Under the proposed formula, the ERC will allow a maximum revenue cap automatically pegged to changes in Consumer Price Index (CPI), but adjusted for productivity and efficiency factors. It also includes the over/under recovery adjustments.

First Regulatory period (January, 2004 to December 31, 2005). The transmission Rates set by ERC order dated September 20, 2002 will be used until December 31, 2003. The new PBR methodology will be implemented starting January 2004- December 31,2005. ERC may extend the First regulatory period to December 31, 2006.

**Comments:**

**I. Article III –First Regulatory Period (pg 18-21)**

1. What will be the based year in determining Maximum allowed Revenue? Year 2002?
2. Calculation of the appropriate initial level of revenue (MAR). The revenue cap should clearly define the components of Maximum allowed revenue and set at a level that includes the ordinary revenue requirement of the transmission company plus the estimated costs of congestion, including losses. The cost of congestion and losses would also need to be made the responsibility of the transmission utility. In this way, the cost of all transmission investment and alternatives would be internalized. With this PBR structure, the transmission utility will have an incentive to address transmission constraint and its associated congestion costs in the most cost-effective manner.

It is likewise important to include the acceptable rate of return in the computation of Maximum allowed Revenue (MAR).

3. The Theory behind the use of the "CPI-X is that a regulated company must be allowed to recover inflationary increases in its input costs, but should not receive additional benefit from productivity improvements that result in lower operating costs which also offset inflationary increases in input costs. This formula directly limits the total amount of revenue a company can receive.

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- 4, Could X be positive if Transmission Company is expected to operate more efficiently in the future? or negative if efficiency declines are expected?
  4. How would the utility account for other costs over which a regulated company had no control like for example the Currency Exchange Rate Adjustment.
  5. On Over/Under Recovery Formula (pg 20). This has to be explained further, On variable it, what is the basis of plus 4% and why the period is October 1 to September 30. are the assumptions realistic to the Philippine situation?

## II. Article IV- Second Regulatory Period (pg. 22-48)

6. The Annual Revenue Requirement (ARRt) computation to be applied for the Second and Subsequent Regulatory Period included estimated corporate income tax (page 26). Does this provision implies that initial level of Revenue also includes corporate income tax to be consistent with the definition?
7. The Working Capital (WCt) is set at thirty (30) days forecast revenue, but may be changed by ERC. There should have a fixed policy on determining the Working capital as it may affect revenue requirement.
8. Weighted Average Cost of Capital and its components should be studied further, again, are the assumptions used applicable to Philippine setting? Consultants uses Australian and American scenario. This should be clearly defined and fixed by ERC for consistency as this would increase the level of regulatory risk in the future.
9. Regulatory Asset Base (pg 32-33) also includes forecast capital expenditure, of the regulated entity as approved by the ERC.

## Article VIII-Service measures and Targets

10. Performance Incentive Scheme (pg 64)

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It is important that regulation encompasses an appropriate incentive framework, encouraging regulated company to strive for efficient costs without necessarily relying on heavy-handed regulation. As soon as the Performance incentive Scheme is developed, there is scope for them to be incorporated into the regulatory cap.

11. One big question probably is whether the data, which would serve as the basis of determining standards of industry performance, are valid or reliable.

**General comments:**

There must be a clear understanding between the regulator and the regulated company as to the application of the proposed revenue cap regulation. It could be better if simulation be made and understand the effect of this methodology to the existing rate level of the regulated company.

ERC should also think and go slow in the proposed shift to PBR scheme, because even the more advanced power markets like Australia and United States are encountering problems on implementing such methodology.

We Reserve the right to make additional comments based on the discussion during the consultations.