

February 14, 2003

Energy Regulatory Commission
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Attention: **Atty. Marina C. Bugayong**
Director, Regulatory Operations Service

Subject: **Draft Guidelines on the Methodology
for Setting Transmission Wheeling Rates
for 2003 to 2027**



Gentlemen:

We thank the Commission for giving us the opportunity to comment on the draft "Guidelines on the Methodology for Setting Transmission Wheeling Rates for 2003 to 2027" and to participate in the public consultation scheduled thereon. Hereunder are the comments and proposals of Dagupan Electric Corporation (DECORP).

General Comments

As provided for in Sec. 43 (f) of R.A. 9136 (Electric Power Industry Reform Act, "EPIRA") and in Rule 15 Sec. 5 of its Implementing Rules and Regulation ("IRR"), the ERC may adopt alternative forms of internationally-accepted rate-setting methodology as it may deem appropriate. The rate-setting methodology so adopted and applied must ensure a reasonable price of electricity. The rates prescribed shall be non-discriminatory.

As proposed in the draft "Guidelines on the Methodology for Setting Transmission Wheeling Rates for 2003 to 2027", the ERC will be shifting from the current practice of Cost-of-Service (COS), or more popularly known as Return-On-Rate-Base (RORB), to a Performance-Based-Ratemaking (PBR) for the setting of the Transmission Wheeling Rates charged by the National Transmission Company (Transco).

The issue of which method is more appropriate is debatable and hence the need for an explanation from the ERC on the purpose of abandoning RORB in favor of PBR. If the ERC believes that the RORB has some inherent flaws, then these flaws must be pointed out. How the proposed method can correct these flaws must also be explained.

The need for a detailed justification from the ERC is to convince all stakeholders that the proposed shift is anchored on the right reasons, and not on what may be a misconception on the current method being used. There were some criticisms against RORB, focusing on revaluation, rate of return, income taxes; these issues are still to be addressed by PBR.

Article 3.1 General Price Control Principles

The proposed methodology for setting Transmission Wheeling Rates calls for the use of Revenue Caps instead of Price Caps. Though both Price and Revenue Caps are the most comprehensive mechanisms for PBR, Revenue Caps do not, however, correct distortions in price signals under COS. Revenue Caps can also seriously hamper the utility's ability to expand sales and compete effectively in contestable market. An increase in demand/consumption – factors not within the control of the utility – will ultimately translate into more revenues. Thus, the use of Revenue Caps may be disadvantageous to the utility.

On the other hand, with Price caps, as demand/consumption grows, revenues increase while the price remains the same, giving the utility a better opportunity to cover costs and earn a reasonable return. With Price Caps, the benefits and risks can be shared between the utility and its customers to ensure mutual welfare and prevent windfall gains. Price Caps make it possible for utilities to compete more effectively by using pricing strategies to retain existing loads and expand sales to new contestable markets.

Article 3.2 Price Control Formula

The Maximum Allowable Revenue (MAR) to be fixed by the ERC for the First Regulatory Period should allow a just and reasonable RORB.

The "starting point" of the PBR is very critical. The starting revenues to be earned by the utility must be sufficient to cover its costs and at the same time earn a reasonable return for the first year of the PBR period. If at the start revenues are low, then this may distort the necessary investments needed by the utility to operate viably.

To leap towards PBR, it cannot be over emphasized enough that at the very beginning, the utility must be allowed to earn a just and reasonable return otherwise the industry will be shifting to PBR on the wrong foot negating any benefits PBR aims to give the various stakeholders.

Article 3.4.1 Over/Under Recovery Formula

Why should there be a penalty of 4% for over recovery? The Annual Revenue Requirement (ARR) and the Maximum Transmission Rates for the year are determined by the ERC, which are based on the proposed Rate Setting Guidelines (Article 6.2.1), or are determined by the ERC if the utility fails to submit its proposed rates within the timelines set. Therefore, if the ARR and the transmission rates are determined or set by the ERC, then why penalize the utility if the same ARR and rates will result to an over recovery?

If the over recovery will be driven by an increase in demand/consumption, why penalize the utility? The growth in demand is not within the control of the utility.



Article 4.4 General Building Blocks

Does the draft Guidelines calls for forecasting each year in the Regulatory Period and calculating what the revenues should be collected under optimal conditions? This so-called prudence review may be a waste of time and resources. The purpose of the formula should enable the ERC to avoid the unnecessary burden of micro-managing the transmission owner.

Article 4.5.7 Primary Building Blocks

What is the basis for fixing the Working Capital at 30 days? Shouldn't this be based on the actual industry collection performance or actual cash turnover? Philippine jurisprudence has fixed Working Capital at 60 days.

Article 4.6.10 Construction Work in Progress

Construction Work in Progress (CWIP) should be included in the Rate Base. In addition, plant investment should be handled through a separate allowance established for new construction. Those new construction investments would then go into Rate Base each year, thus increasing allowed revenues independently of the PBR.

In the next year that new construction portion of the revenue requirement would be escalated should be part of the formula. This point is crucial since congestion investments and reliability improvement investments are not likely to be covered by growth in load and/or growth in customers. These investments must be independent of the PBR.

If investment is not handled in this fashion, the transmission owner will have little incentive to make the necessary capital investments to relieve congestion points on the transmission system, thus frustrating the development of wholesale competition. Moreover, reliability improvements that will improve service to customers may likely end up being deferred or not pursued at all, unless incorporated into rates of the PBR.

Article 4.11 Operating and Maintenance Expenditure


To benchmark all these data against utilities in other countries may not be helpful. The characteristics of transmission service in other countries are not likely to resemble the Philippines. The ERC should stick with the PBR formula and benchmark Transmission Wheeling Rates against other ASEAN nations to see if the transmission owner is at least commensurate with other utilities. If prices are significantly higher (assuming the data is available for transmission only) than other ASEAN nations, then the transmission owner should be required to justify why this is so. The key to PBR is PRICES, not costs. A primary goal of PBR is to break the cost-price link.

It should be noted that it also costs money to collect this data - money that must be paid by the transmission customer. It is likely that the transmission customer could not care less about all this data. The customer is primarily concerned with the price for transmission service and whether or not the customer is getting a fair deal. If the customer sees that transmission prices in the Philippines are comparable to those in other ASEAN nations, this should be sufficient.

DECORP hopes that the Commission will consider the foregoing concerns and we look forward to actively participate in the public consultation scheduled on February 19 to 21, 2003.

Very truly yours,

Dagupan Electric Corporation


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