



National Transmission Corporation

CorPlan-TransCo
TDAD 2003-02
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Hon. LETICIA V. IBAY
Acting Chairman
Energy Regulatory Commission (ERC)
Pacific Centre Bldg., San Miguel Ave.
Ortigas, City of Pasig

Subject: Comments on the Guidelines on the Methodology for Setting
Transmission Wheeling Rates for 2003 – 2027

Dear *Chairman Ibay*:

In connection with the Commission's Notice on ERC Case No. 2003 – 34 entitled "In the Matter of the Adoption of an Alternative Form of Rate Setting Methodology for the National Transmission Corporation (TransCo) and any Future Concessionaire Thereof", we are hereby furnishing the Commission an advanced copy of TransCo's comments on the matter.

However, we request the Honorable Commission that we be allowed to provide additional comment(s) on the guidelines as this primarily addresses the methodology for setting the National Transmission Corporation's wheeling rates to which we are the principal party concern.

For the Commission's consideration.

Respectfully yours,

EDGARDO M. ORENCA
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TransCo's Comments on the Guidelines on the Methodology for Setting Transmission Wheeling Rates for 2003 – 2027	
Location/Issue	TransCo's Comments
(1) New Rate Setting Methodology	A thorough study of the methodology should be endeavored by active participation of the industry players and the regulator should take the lead in the collaborative/consultative meetings. Formal public hearing shall be conducted to facilitate appropriate and successful implementation of the new rate setting methodology.
(2) Definition of "Regulated transmission services" (a) transmission of electricity through the Grid (b) those services provided by the Regulated Entity in its capacity as System Operator (c) ancillary services provided or paid for by the regulated entity in its capacity as the system operator (d) the installation and maintenance of components of the grid	<p>Since ancillary services are provided by generators who are free to compete, how can the price of ancillary services be regulated? ERC-approved Ancillary service rate may be viewed as too low and it might happen that no generator would offer their ancillary services at that price? Will the system be left with no reserves, no capacity for frequency regulation, and without capacity for load following ancillary services?</p> <p>Presently, ancillary service is not considered as revenue of TransCo but merely a pass-through item. TransCo merely serves as a collector of the service provider.</p> <p>It is suggested that Ancillary Services should be regulated using another form of regime.</p> <p>Meanwhile, it has been observed that there is no mention of the Connection Charges which TransCo includes in its Terms & Conditions.</p>
(3) Definition of the term "Customer"	<p>The definition proposed by ERC seems to limit the customer of TransCo to load customers. We recognized that historically, many transmission entities charge just loads, especially where the transmission entity was part of a vertically integrated generation and transmission company. However, there has been a move to keep away from such charging structures as the economic efficiency cost become apparent, it is now a practice that transmission companies charge connection charges to generators to provide investment location signals. The definition of ERC seems to rule out connection charges, and refrain TransCo from a billing structure which would not appear consistent with the principles established in the EPIRA.</p> <p>We suggest that the Commission considers TransCo's proposed definition on Transmission Customer: <u>Any party purchasing and/or receiving any services from the Transmission Provider or System Operator (including, for the avoidance of doubt, customers</u></p>

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	<p><u>taking service without an existing contract).</u></p> <p>If in the definition of Customers does not include generators, this will greatly affect the classification of ancillary services whether as revenue or not of TransCo.</p>
<p>(4) Definition of Force Majeure (FM) Event and Permitted Force Majeure Pass Through Amount</p>	<p>This does not explicitly provides for 'change in law' as a Force Majeure Event, though the definition of Permitted FM Pass Through Amount provides for increased cost incurred... (b) in complying with the provisions of any legislation, or of any rules, regulations or guidelines made under the EPIRA, including IRR and Grid Code...</p> <p>Should the 'change in ERC guidelines' be considered as part of letter (b) or 'change in law'.</p>
<p>(5) Definition of Trigger Condition</p>	<p>The word 'formula' used in the definition should mean the complete formula for the Maximum Revenue Cap, to include the letters designation, numbers constant and functions.</p>
<p>(6) 2.2 First Regulatory Period</p> <p>Concessionaire provides a written request to the ERC to terminate the First Regulatory Period in accordance with Section 2.2.2</p> <p>First Regulatory Period will end on 31 December</p>	<p>This gives no elbow room for TransCo to petition for new rates using the new methodology until December 2005. It should be noted that the recently approved TransCo tariff does not "mirror" the revenue of the transmission business during the first regulatory period, simply because the approved rates were based on undervalued or reduced values of assets, unreasonable disallowance of expenses, reduced working capital and other issues that we believe are still contestable. We also believe that this is not reflective of the true cost of transmission.</p> <p>More importantly, it has to be considered that, as of this date, the transmission facilities of NPC have not been transferred to TransCo hence, the assets have not been completely identified and properly valued.</p> <p>Per guidelines, TransCo is not yet given the right to petition ERC for the early termination of the First Regulatory Period, hence cannot petition ERC for new tariffs adjustments.</p> <p>In the event a Concession is not awarded during the first regulatory period, TransCo should be allowed to petition for new tariff adjustment using the new methodology.</p>

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<p>(a) 2004, - if the appointment of Concessionaire occurs during 2003 and the Concessionaire provides a written request to the ERC to terminate the Interim Regulatory Period</p>	<p>The June 2003, is too short a time, we don't foresee an awarding of the Concession on or before this date, more so in the absence of the Franchise Bill. Even if the Franchise bill is approved between before June 2003, it would still be time limiting to award the Concession before the June 2003.</p> <p>And in the event the nature of the Concession is limited to Maintenance and Expansion, wherein the operation of the grid is left with TransCo, TransCo should be allowed to request for the early termination or extension of the first regulatory period.</p>
<p>(7) Timing for Regulatory Periods</p> <p>2.5.1 Each Subsequent Regulatory Period must be 3,4, or 5 calendar years in duration.</p>	<p>Three years is too short, we suggest a minimum of four (4) years.</p>
<p>(8) 3.2 Price Control Formula</p> <p>Maximum Allowed Revenue during the First Regulatory Period</p> <p><u>P20.198Bn</u></p>	<p>ERC should review, evaluate and confirm this figure. Also, we suggest that when the Financial figures of CY 2002 become final and available ERC should glimpse the initial year financial operation of TransCo. ERC should use the most up to date information when setting the revenue requirement for the first regulatory period.</p> <p>The P20.198Bn is a figure which was derived simply by multiplying the 2003 demand forecast, per grid to the ERC approved transmission delivery charge (per grid). This does not include revenue from the following services, System Operations Charge, Supply and Metering Charge, Connection Charge and Sub-Transmission Charge.</p> <p>More importantly, TransCo's Demand Forecast should be reviewed and updated.</p> <p>In the calculation of the Maximum Annual Revenue (MAR) certainly the system losses should be considered in the computation of MAR.</p> <p>If the Commissioner will consider this in the determination of the MAR, the derived revenue will be greater than the P20.198Bn.</p> <p>On another note, should the demand and the corresponding revenue forecast be the same with those</p>

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	<p>data submitted to the Department of Budget and Management (for 2003)?</p> <p>We maintain our position that the Ancillary Services Charges are not revenue of TransCo for several reasons (see Comments on Regulated Transmission Services).</p>
<p>(9) 3.3 Change in CPI</p> <p>CPI for Regulatory Year t (I_t)</p> <p>Formula: $I_t = \{CPI_{t-1} / CPI_{t-2}\} - 1$</p>	<p>We request that the Commission spell out the method of calculating I_t. In addition, is it necessary to use CPI per quarter – can the Commission simplify the calculation to refer to the change in the CPI.</p>
<p>(10) 3.4 Over/Under Recovery Formula</p> <p>ATR_{t-1} and other formulae</p>	<p>It would be appreciated if the Guidelines will expressly provide if these are calculated on a cash or accrual basis.</p>
<p>(11) 4.5 Primary Building Blocks</p> <p>4.5.7 $ARR_t = OPEX_t + Tax_{0,t} + [(RAB_t + WC_t) \times WACC_c] + Tax_{c,t}$</p> <p>RegDepn_t = The Regulatory Depreciation for Regulatory Year t in real terms as determined by the ERC...</p>	<p>We surmised that ERC now considers a post-tax approach and considers income tax as part of the operating expense.</p> <p>May we be clarified on the formula of ARR_t, as we read it, we see an apparent mixture of real and nominal terms.</p> <p>Does the regulated depreciation considered in the formula pertain to revalued assets including revaluation increment?</p>
<p>(12) 4.6 Asset Valuation</p> <p>4.6.3 Initial Re-valuation must be undertaken using an optimized replacement cost approach...</p>	<p>May we note that there are different languages used in this guidelines as to the requirement of independent expert. In some provisions, the guidelines state that 'ERC <u>may</u> require the Regulated Entity to retain an Independent expert, e.g. 4.6.2, while this is different in 7.1.4 a which provides that 'ERC <u>must</u> require the regulated entity to retain...</p> <p>It would highly appreciate if the Commission will provide us clear basis/guidelines where TransCo is required to retain an independent expert. This should cover foreign and local companies providing asset valuation expertise.</p> <p>As we anticipate a rapid expansion of the transmission infrastructure, it is wise to re-value assets as frequent as needed. Presently, TransCo is advised (by PSALM) not to revalue its assets prior to privatization</p> <p>The assets of NPC/TransCo are valued in its books</p>

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	<p>under the current cost accounting (revalued considering the replacement cost of assets), no service requirement optimization is applied and existing assets are valued using modern equivalent assets.</p> <p>The guidelines recommends an immediate shift to the Optimized Replacement Cost Approach, if the concessionaire comes in late in the year 2004, it will not have enough time to revalue its assets in accordance with 4.6.7 – that initial re-valuation must be 12 months prior to the commencement of the second regulatory period and report must be submitted to ERC 11 month prior to the commencement of the Second Regulatory Period. How could this be addressed? Unless, TransCo is allowed to have its assets revalued now, it might meet the required dates provided in the guidelines. But then again, TransCo is advised not to re-value its assets and besides it does not have budget for such activity.</p>
<p>4.6.8 differentiate between assets which are to be included or excluded in the RAB</p>	<p>Will the Commission define what it meant of 'reasonable quantities' of spares? Will the Commission provide a guideline on this? And when?</p>
<p>4.6.8 (c) in case of spares are in reasonable quantities as determined by the ERC...</p>	<p>Please allow us to inform the Commission, that as of this date not all easements are documented. We suggest that this be modified (RAB for the Second RP) to recognize the real situation.</p>
<p>4.6.8 (d) in the case of easements, are clearly documented as being owned by the regulated entity.</p>	<p>Will there be specific guidelines that the Commission will provide for the calculation method? Or will the Commission require the regulated entity to submit a calculation method for its approval?</p>
<p>4.6.10 Construction Work in Progress (CWIP) ... The investment cost shall be derived from a calculation method approved by ERC...</p>	
<p>(13) 4.9 WACC Determination</p> <p>4.9.2 For these purpose a 'classical' WACC (WACC_c) is to be used as in the ERC's view it best balances the financial Building Blocks in Section 4.5.7.</p>	<p>The term 'classical' WACC is not very clear. The guidelines impliedly provide that ERC recognize the use of post-Tax WACC, however, it would be highly appreciated if ERC would make it explicitly clear whether it is pre or post tax.</p>

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<p>(14) 4.10 Capital Expenditure program</p> <p>4.10.2 (b) the reason the project has been prioritized above other projects.</p> <p>4.10.6 The capital expenditure forecast provided by the Regulated Entity as part of the CAPEX program must be provided in nominal terms...</p> <p>4.10.8 As part of the regulatory reset process for the second regulatory period under Article VII, the ERC must identify those projects which is considers to be of major importance (including the Leyte-Mindanao sub-sea interconnection</p>	<p>The regulator should address the volatility of price in the country, since it is difficult to estimate the costs of project way into the future.</p> <p>Can we be cleared on the meaning of 'prioritized above other projects'? Does it mean prioritization of such projects to other projects included in the CAPEX forecast, or ERC has another reference to it?</p> <p>To report a CAPEX forecast in nominal terms would mean a consideration of an inflation factor in the forecast. Will the Commission provide the inflation forecast?</p> <p>The guidelines provide that the capital expenditure forecasts would only include costs for assets that come into service during the year or simply the commissioning date. It is suggested that the Commission adopts a rolling forward of forecast capital expenditure on an <i>ex-ante</i> basis to the asset base annually.</p> <p>Will ERC be issuing guidelines on what it will consider as projects of 'major importance', and why Leyte-Mindanao Interconnection was given as an example?</p>
<p>(15) 5.1. Subsequent Regulatory Periods</p> <p>5.6.1 ...except that re-valuation must value material items of plant and equipment <u>at their optimized deprival value</u>...</p> <p>5.8.1 Regulatory Depreciation</p>	<p>We are just wondering why ERC should change from Optimized Replacement Cost in the Second Regulatory Period then changed to the Optimized deprival value on the Third (Subsequent) Regulatory Period. We learned that experience from other regimes that have adopted this method shows that it is problematic and is only best appreciated in a well-established transmission network, not like in this country. We recommend that changes (anywhere in this regime: formula or otherwise) would require public consultation with the regulated entity(ies).</p> <p>The change in the approach to regulatory depreciation should also ensure that the regulated entity does not</p>

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	under-recover.
<p>(16) 6.2 Annual Rate Setting</p> <p>6.2.1.g If the regulated entity fails to file its submission on its proposed maximum transmission wheeling rates...</p> <p>6.4.1 to 6.5.1</p>	<p>The guidelines do not provide any provisions in case of late filing by the regulated entity.</p> <p>Based on the ERC ruling on the Unbundled Power Rates of NPC, the cross-subsidies under the Transmission charges will be phased out by the end of 2005. This does not coincide with the provisions of the EPIRA which provides among others, that the removal of cross subsidies should be within three (3) years from the imposition of the Universal Charge. It is most likely to happen that TransCo will have removed the cross-subsidy ahead of the provision of the law. It is suggested that the Commission amending the 6.5.1 to include the provision for the cross subsidy removal scheme already imposed by ERC, in ERC Case No. 2001-901.</p>
<p>(17) Regulatory Reset Process</p> <p>7.1.9. All written submissions must be made within one (1) month of the publication of the draft determination</p>	<p>Will the Commission consider a longer period because the 1 month time is too short?</p>
<p>(18) 8.1 Establishment of Transmission Reliability Standards</p>	<p>It should be noted that the regulated entity is to propose a capital expenditure forecast for the 2nd Regulatory period for the reset process. We suggest that the performance targets be set sooner in order for the regulated entity to develop a capital program to deliver them.</p>
<p>(19) 9.2.4 For purposes of calculating the Net Capital efficiency gain, or the net operating and maintenance efficiency gain, for a regulatory year t the ERC may, at its discretion, adjust the capital expenditure forecast approved by the ERC for regulatory year t...</p>	<p>The Commission should reconsider the phrase "at its discretion", as this may create uncertainty. It is something undesirable for ERC to adjust the capital expenditure or operating expenditure forecast in light of the expenditure savings in the middle of the regulatory period. It is suggested that this can be handled as part of each process when setting the allowed revenue for the forthcoming review period.</p>
<p>(20) 10.2 Claim for a Force Majeure Event</p>	

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<p>10.2.4 ... might result in the price for electricity paid by any end-user increasing by more than PhP0.02/PkWh in the regulatory year...</p>	<p>May we request for the rationale and basis of the PhP0.002/PkWh.</p>
<p>(21) 12.8.1 Deferred Capital Expenditure on Projects of Major Importance</p>	<p>Could ERC provide as a definition of "Projects of Major Importance"?</p> <p>May we be clarified on the reason on why would ERC alter the value of X in the formula for calculating the MAR cap as already set out in 4.2.1. by recalculating the X factor based on the exclusion of the forecast capital expenditure (project of major importance not undertaken within 18month of the time it was forecasted)? We understand that ERC can address this at the time of each reset. Regulatory intervention during a regulated period may create uncertainty.</p>
<p>(22) 14.2.5 The cost of any independent expert retained pursuant to this Article XVI must be borne by the regulated entity</p>	<p>We would highly appreciate if the guidelines will make it clear that the ERC will ensure that the allowed revenue will take into account the expected cost that the regulated entity will incur in appointing all these independent experts.</p>
<p>(23) Others</p> <p>Connection Charges</p> <p>Re-Opening Trigger Events The percentage change in CPI between two (2) consecutive quarters w/in the then current regulatory period, is greater than 10%. The percentage in the three-month average of non-coincident peak demands (over all connection points existing at the beginning of the three month period) between 2 consecutive...</p> <p>Performance Indices and Metrics</p>	<p>There is no mention in the guidelines on Connection Charges, will the Commission consider this in the MAR calculation of the regulated entity?</p> <p>The change in CPI to exceed 10% in 2 consecutive quarters rarely happens in the country.</p> <p>We suggest that a collaborative/consultative meeting be conducted to determine the standards and indices to measure reliability.</p>