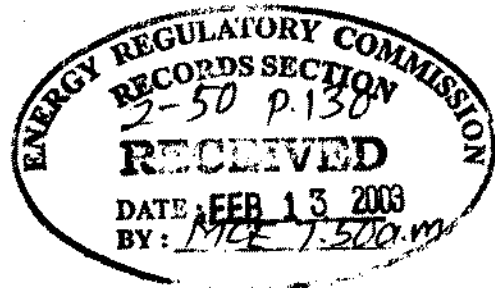




12 February 2003

HON. LETICIA V. IBAY
Acting Chairman
Energy Regulatory Commission
Pacific Center Building
San Miguel Avenue, Pasig City



Dear Hon. Ibay,

We are hereby submitting our comments on the "Draft Implementing Rules for the Deferred Incremental Currency Exchange Recovery (DICER) and Deferred Energy Cost Recovery (DÉCOR)". Please see the attached sheets for details.

We look forward to our participation as we send our representatives in the February 17 public consultation.

Yours truly,

WANNA G. DELA PEÑA
Senior Asst. Vice President
Head, Utility Economics

COMMENTS ON THE DRAFT IMPLEMENTING RULES FOR DÉCOR AND DICER

General Comments:

The use of the DÉCOR and DICER is a departure from the usual practice of using automatic mechanisms for the recovery of purchased power and foreign exchange losses. This will require utilities to advance the additional costs of power and debt service payments until such time that the Commission allows it to pass on these additional costs plus carrying charges. This will eat up on the distribution revenues of utilities or force utilities to borrow funds. The use of the 91-T bill rates as basis for the carrying charge assumes that there are always available funds for the utility to borrow at this given rate.

On the customer side, deferred cost may not be billed to the customers who incurred the cost in the first place. Customer consumption changes monthly and those customers who happen to consume more, share more of the cost regardless of whether they consume less in the past, when the deferred costs were incurred. Moreover, cost deferrals result into higher rates as deferred costs and corresponding carrying charges pile up requiring higher rate adjustments.

Detailed Comments:

Sec. 1

Adjustment Date

Upon receipt by the Commission of the application by the DUs regarding deferred generation costs and deferred accounting adjustment, how long will it take before the Commission make its approval? A definite time period should be set within which the Commission should decide on applications related to these adjustments, otherwise, the costs that DUs advance do not immediately become recoverable for which the DUs incur additional financing costs.

Recovery Period

What is the rationale in setting the 3-year recovery period? Clarification is also sought on the different treatment of the 3-year period as a minimum or maximum for DÉCOR and DICER, respectively. There should be a basis for setting the recovery period.

Test Period

This should be clearly defined and differentiated from the other periods mentioned in the proposed implementing rules.

Sec. 3

Interest income and expense

The inclusion of interest expense and income in the deferred accounts should be looked into thoroughly with respect to tax implications and to Sec. 43f (ii) of R.A. 9136 which states that interest expenses are not allowable deductions from permissible return on rate base.

Sec. 4

Net Purchased Power

Purchased power under current rates includes both generation and transmission charges. Although transmission charges are fixed per kW rates, these charges change monthly on a per

kWh basis depending on the volume of kWh purchased. What would be deducted from purchased power to arrive at net purchased power?

Sec. 5

Significant Change in Purchased Power Cost as a basis for ERC Filing

What is the basis of the Commission in designating 5% as a significant change? The magnitude of the increase will vary depending on the base purchased power cost of the utility. For Meralco, the 5% would translate to a really significant 22-centavo change based on the January 2003 purchased power cost of P4.36 per kWh. For other utilities with lower purchased power cost, the significant change would be much lower. For DICER, the 5% percent change would only amount to a very small value considering that the Base Currency Adjustment rate may be very low. It may be more appropriate to set a fixed rate per kWh change rather than set a percentage that is based on values that differ for each utilities.

Sec. 8

Eligibility for Recovery in Accordance with the "Current Policies of the Commission"

Are the ERB approved purchased power contracts no longer valid if they run counter to the "current policies of the Commission" considering that these contracts are entitled to stranded cost recovery under Sec. 33 of R.A. 9136? This section just gave only two conditions for contracts to be eligible for stranded cost recovery namely: ERB approval and that the approval should be no later than Dec. 31, 2000.

Sec. 9

Carrying Charges

It should be defined how the carrying charge is computed; whether it is based on end of period or an average. Also, it can be noted that ERC guidelines propose different benchmarks. The Commission should set standard benchmarks for carrying charges.

The 91-day T-bill rate to be used in computing carrying charges does not reflect the actual cost of borrowing. In reality, Meralco will end up shouldering more than the carrying charge if there is an under-recovery, since its borrowing cost is higher than the 91day T-bill and it pays taxes on the interest. On the other hand, if there is an over-recovery, Meralco's gain is less than the 91day T-bill rate because it pays a 20% final tax on the interest from its placements.

Sec. 10

In the preparation of the monthly reports, an extension from the 10-day period is sought for the DUs to submit to the Commission a report containing all transactions and calculations affecting the deferred accounts. At present, it will take 15 days, at the minimum, before said report can be accomplished.

Sec. 11 (DÉCOR)

This section should specify the conditions that would compel the ERC to issue an exception from Sections 2 to 9. Otherwise, this clause gives too much leeway for changes in the recovery mechanism without due process.