

Republic of the Philippines
ENERGY REGULATORY COMMISSION
San Miguel Avenue, Pasig City

IN THE MATTER OF THE
APPLICATION FOR APPROVAL
OF THE REVISED RATE
SCHEDULES IN COMPLIANCE
WITH SECTION 36 OF REPUBLIC
ACT NO. 9136 AND ERC ORDER
DATED OCTOBER 30, 2001, AND
FOR APPROVAL OF APPRAISAL OF
PROPERTIES, WITH PRAYER FOR
PROVISIONAL AUTHORITY

ERC CASE NO. 2001-892

CAGAYAN ELECTRIC POWER
AND LIGHT COMPANY, INC.
(CEPALCO), Applicant.
X-----X

DECISION

Before the Commission for resolution is the application filed on December 21, 2001 by applicant Cagayan Electric Power and Light Company, Inc. (CEPALCO) for approval of its revised rate schedules in compliance with Section 36 of Republic Act No. 9136 and ERC Order dated October 30, 2001, and for approval of appraisal of properties, with prayer for provisional authority.

Having found the application sufficient in form and substance with the required fees having been paid, an Order and a Notice of Public Hearing were

issued both dated January 31, 2002 setting the same for initial hearing on March 4 and 5, 2002.

In the same Order, applicant was directed to publish at its own expense, the Notice of Public Hearing twice for two (2) successive weeks in two (2) newspapers of general circulation in the Philippines at least two (2) weeks before the date of initial hearing.

Copies of the application, the Order and the Notice of Public Hearing were furnished the Office of the Solicitor General (OSG), the Commission on Audit (COA) and the Committees on Energy of both Houses of Congress and were requested to have their respective duly authorized representatives present at the initial hearing. Copies of the Order and the Notice of Public Hearing were likewise furnished the Mayors of the city and municipalities within applicant's franchise area for the appropriate posting thereof on the bulletin boards of the said city and municipalities.

During the March 4, 2002 initial hearing of this case, only applicant and intervenor Robert Mallillin appeared. No oppositor appeared nor was there any opposition registered herein. Applicant presented its proofs of compliance with the Commission's publication and posting of notice requirements and had these marked as Exhibits "A" to "C-3", inclusive. It then moved that an order of general default be made against all parties who might be minded to oppose the application. Said motion was noted. Thereafter, it presented its first two (2) witnesses, Ms. Chiquita Capili, applicant's Assistant Vice President and Comptroller and Mr. Maximo Montes, Acting President, Asian Appraisal Company, for direct examinations. Ms. Capili testified on the procedures she followed in the

preparation of the schedules submitted in compliance with Section 36 of Republic Act No. 9136. Mr. Montes testified on the manner by which the applicant's properties were appraised which were the values used in the different schedules using the unbundling process. In the course thereof, documents were presented and marked as Exhibits "D" to "R", inclusive.

After the termination of the direct examinations, Mr. Mallillin conducted cross-examinations of the said witnesses while the Commission propounded clarificatory questions to them.

During the March 5, 2002 hearing, same parties appeared. Applicant agreed to come up with a reappraisal of the land being used by the applicant in its operations in order to reckon the value of land with test year 2000 and submit a revised report on the said appraisal. Thereafter, Ms. Capili was recalled to witness stand for additional clarificatory questions by the Commission.

Applicant's third witness Ms. Maria Veronica Pore, Branch Manager of Sycip Gorres and Velayo; Cagayan de Oro was then presented for direct examination. In the course of her testimony, a document was presented and marked as Exhibit "S". Witness Pore testified on the audit she conducted on applicant's financial books of account.

In the course thereof, applicant was directed to submit the following: 1) the Interest Rate of its Foreign Loans; and 2) an explanation on the Co-incident Peak being Equal to the Non-coincident Peak.

Applicant moved that it would submit its revised appraisal for the land used in its operations within three (3) weeks from said date of hearing and then make its formal offer of evidence after it has submitted all the required documents. Said motion was granted.

On August 16, 2002, intervenor Mallilin filed its "Manifestation" which seeks to require applicant to file Revised Schedules for Schedule 75, 85 and 95.

The Commission directed applicant to comment on the said manifestation in its Order dated September 2, 2002.

On October 14, 2002, applicant filed its "Comments on NICA Manifestation".

A "Manifestation" was filed by intervenor Mallilin on October 25, 2002 commenting on the said comment.

On January 12, 2004, applicant filed its formal offer of exhibits.

On March 2, 2004, the City Council submitted to the Commission a Resolution No. 6468-2004 opposing the application filed by CEPALCO.

The Commission directed applicant to comment on the said manifestation in its Order dated March 2, 2004.

On March 31, 2004, applicant CEPALCO submitted its "Comment on City Council Resolution"

I. CEPALCO'S PROPOSAL

CEPALCO's proposed rate structure reflects the unbundling of rates in accordance with the sectors or functions identified in Section 5, R.A. 9136. These rates were developed on the basis of the data and calculations contained in the schedules prescribed in the Uniform Rate Filing Requirements (UFR) as per ERC Order dated October 30, 2001, as follows:

TABLE 1

RATE SCHEDULE	REFERENCE
1. Rate Schedule 16	Flat Rate Service
2. Rate Schedule 26	Residential meter
3. Rate Schedule 36	General Service up to 5 kW connected load
4. Rate Schedule 46	General Service up to 37.5 kW connected load
5. Rate Schedule 56	General Power with Guaranteed Billing Demand of not < 30 kW up to 2.5 MW
6. Rate Schedule 66	General Power with Guaranteed Billing Demand of > 2.5 MW
7. Rate Schedule 75	Bulk Power customers connected to 69 kV
8. Rate Schedule 85	Bulk Power customers connected to 138 kV
9. Rate Schedule 95	Bulk Power customers connected to 138 kV inside the PHIVIDEC ^{a/} Industrial Estate

^{a/} PHIVIDEC – Philippine Veterans Development Corporation

I. A. Revenue Requirement

CEPALCO calculated its Total Revenue Requirement based on test year 2000 using the Return on Rate Base (RORB) methodology. The application contains assets valued both at historical costs and appraised value. CEPALCO's calculation used the appraised or sound value of assets, as underlying basis for the formulation and design of the Revised Rate Schedules. The submitted historical cost of assets, as required in the UFR was solely for informational purposes, and not as basis for ratemaking.

On the basis of the submitted schedule (Schedule B), the proposed Total Revenue Requirement amounted to PhP1,539,488,000, which was calculated by adding total cost of service and the total return on rate base (computed at 12% of the rate base). Details as follows:

TABLE 2

Account Name	In Thousand Pesos		
	Total Company	Non-Electric	Adj. Electric
Fuel	Php 9,701	0	Php 9,701
Purchased Power	1,035,810	0	1,035,810
Payroll	44,034	0	44,034
O & M (less Fuel, PP and Payroll)	82,523	(3,387)	79,136
Depreciation & amortization	125,143	(2,603)	122,540
Income taxes	16,268	0	16,268
Other expenses (Franchise Tax)	36,133	0	36,133
Return on Rate Base *	211,264	(15,398)	195,866
Revenue Requirement *	PhP 1,560,876	(21,388)	PhP 1,539,488
Less: Other revenue items	0	0	0
Total Revenue Requirement	PhP 1,560,876	(PhP 21,388)	PhP 1,539,488

Note: CEPALCO's Rate Base and Revenue Requirement were erroneously overstated by P200,000.

I.A.1. Operating Revenue

CEPALCO reported a breakdown of the total operating revenue per customer class for the year 2000, as follows:

TABLE 3

Customer Type	Total Revenue (in Thousand Pesos)
Sch 25-Residential	PhP 6,033
Sch 35-Commercial	381,962
Sch 45-Commercial	168,180
Sch 55-Industrial	145,034
Sch 75-Bulk Power	369,005
Sch 15-Flat Rate	337,592
Total	PhP 1,407,806

CEPALCO excluded in the above operating revenue its income from Currency Exchange Rate Adjustment (CERA) amounting to PhP27,613,000.

I.B. RATE BASE

CEPALCO proposed that Schedule B (Restated Value of assets) be used as basis in the determination of its Rate Base. Thus, CEPALCO utilized the

appraised value of assets as of December 31, 1999 as reported by an independent appraiser, Asian Appraisal Company, Inc. (AACI) dated May 15, 2000, however, land assets were further adjusted by the appraiser in the Appraisal Report dated March 20, 2002, to reflect re-appraisal of land as of December 31, 2000 per instruction of the Commission during the March 4, 2002 hearing (TSN p.109). The proposed rate base is as follows:

TABLE 4

	In Thousand		
	Total Company	Non-Electric	Adjusted Electric
Distribution Plant	PhP 1,569,652	0	PhP 1,569,652
General Plant *	376,377	(127,775)	248,602
Total Plant in Service	1,946,029	(127,775)	1,818,254
Less: Accumulated Depreciation			
Distribution Plant	(420,379)	0	(420,379)
General Plant	(73,406)	0	(73,406)
Total	(493,785)	0	(493,785)
Net Plant in Service	1,452,244	(127,775)	1,324,469
Construction Work In Progress (CWIP)	113,711	-	113,711
Net Plant in Service (incl. CWIP)	1,565,955	(127,775)	1,438,180
Add: Materials & Supplies	0	0	0
Cash Working Capital	194,580	(546)	194,034
Total Rate Base	PhP 1,760,535	(128,321)	PhP 1,632,214

Note: General Plant land asset (Brgy. Igpit) was erroneously overstated by P200,000

I.B.1. Plant in Service

I.B.1.a. Asset Valuation

In support of its unbundled rates application, CEPALCO submitted for approval of the Commission a report of AACI with respect to sound value of its properties existing as of December 31, 1999 and land re-appraisal as of December 31, 2000. Based on the said reports, CEPALCO's assets were appraised based on cost level as of December 31, 1999 at the prevailing Peso-to-Dollar exchange rate of PhP40.313 to US\$1.00 with total cost of reproduction (new) of PhP2,012,065,570 and sound value of PhP1,572,930,754, to wit:

TABLE 5

Particulars	Cost of Reproduction, New		Sound Value	
Distribution Plant				
Land	PhP	62,595,000	PhP	62,595,000
Structures and Improvement		14,722,000		10,804,000
Station Equipment		184,917,000		114,307,500
Poles and Fixtures		366,612,200		263,100,200
O/H Transmission and Distribution		291,532,900		206,879,400
Line Transformers		375,560,000		275,003,000
Services		33,124,600		22,681,000
Consumer's Meters		296,751,400		229,934,000
Streetlighting		4,708,500		2,590,500
Non-Utility Properties		18,961,000		18,961,000
Total	PhP	1,649,484,600	PhP	1,206,855,600
General Plant				
Land	PhP	176,295,000	PhP	176,295,000
Condominium Units		52,169,000		52,169,000
Structures and Improvement		16,927,000		9,028,000
Transportation Equipment		39,333,000		34,493,000
Tools, Shop & Garage Equipment		21,360,440		13,794,554
Laboratory Equipment		22,192,130		16,299,000
Communications Equipment		11,314,200		6,889,600
Miscellaneous Equipment		3,636,100		2,585,500
Furniture & Office Equipment		19,354,100		9,521,500
Total	PhP	362,580,970	PhP	321,075,154
GRAND TOTAL	PhP	2,012,065,570	PhP	1,527,930,754

I.C. WEIGHTED AVERAGE COST OF CAPITAL

CEPALCO proposed for a Weighted Average Cost of Capital of 12% or equivalent to a return of PhP 211,264,208, computed as follows:

TABLE 6

Component	Amount as of 12/31/00	Component as % of Total	Component Cost of Capital	Weighted Cost of Capital
(a)	(b)	(c)	(d)	(e)
Long Term Debt	PhP 335,322,764			
Short Term Debt	327,859,920			
Total Debt	PhP 663,182,684	39.66%	24.47%	9.71%
Stockholders Equity	PhP 1,192,895,606			
Less: Revaluation	PhP 184,115,015			
Stockholders equity net of Revaluation	PhP 1,008,780,591	60.34%		2.29%
TOTAL DEBT & EQUITY	PhP 1,671,963,275	100.00%		12.00%
Proposed Rate Base				PhP 1,760,535,071
Proposed RORB				PhP 211,264,208

I.D. RATE DESIGN

CEPALCO's proposed rate consisted of charges for the following specific functions: a) Generation/Transmission, b) Distribution, c) Supply, and d) Metering.

I.D.1. Generation Charge

CEPALCO proposed for a Power Cost Charge formula for customer classes served through distribution lines rated below 69 kV as Generation and Transmission Charges for the recovery of its power cost:

$$\text{PCC} = \frac{\text{A}}{\text{B} - (\text{C} + \text{D})} \times \frac{1}{1 - \text{FT}}$$

Where:

PCC = Power Cost Charge

A = Total cost of power purchased for the previous billing month for all customers served through distribution lines rated below 69 kV or customers under Rate Schedule 15 - 55

B = Total kWh purchased for the previous billing month for all customers served through distribution lines rated below 69 kV or customers under Rate Schedule 15-55

C = Actual system loss for all customers served through distribution lines rated below 69 kV (Schedule 15-55) but not to exceed the maximum recoverable rate of system loss plus actual kWh used by the company not to exceed 1% of the total kWh purchased and generated.

D = kWh sold to subsidized consumers under Schedule 15 and Schedule 25 consuming 0-15 kWh per month.

FT = Franchise Tax

I.D.2. Currency Exchange Rate Adjustment (CERA)

CEPALCO proposed a Currency Exchange Rate Adjustment (CERA) formula when the Peso requirement to service foreign obligations using the most recent currency rates of exchange is more or less than the base exchange rate,

the energy charges per kilowatt-hour to all kilowatt-hour blocks in all schedules of rates shall be adjusted according to the following formula:

$$C = \frac{A - B}{K \times R}$$

Where:

- A = Actual debt in foreign currency serviced in Pesos for the quarter preceding the current quarter
- B = Base debt in foreign currency serviced in Pesos for the quarter preceding the current quarter
- C = Currency Exchange Rate Adjustment Factor
- K = Total kilowatt-hours sold in the quarter preceding the current quarter
- R = 1.00 less Franchise Tax Rate

I.D.3. Line Losses

CEPALCO proposed a moving average system loss (12 months) to recover a line loss of 9.5% to total system loss and not only to customers subject to Power Cost Charge (PCC). This means including the bulk power customer's pre-agreed system losses and for as long as CEPALCO's average system loss does not exceed the 9.5%, it should be allowed to recover said losses.

I.D.4. Distribution Charge

CEPALCO proposed a fixed peso per kilowatt-hour for distribution charge to its customers with a combination of fixed minimum charge for a certain kWh used and a declining peso per kilowatt-hour for the succeeding kWh used.

I.D.5. Supply and Metering Charges

CEPALCO proposed a peso per kilowatt-hour for supply and metering.

I.E. INTERCLASS CROSS SUBSIDY

CEPALCO estimated the level of cross-subsidies incorporated in the rate structure. The cross-subsidies enjoyed or borne by each customer class are summarized below:

TABLE 7

Customer Class	Adjusted kWh Sold (Historical Year)	Total Computed Revenue (Based on Model)	Normalized Revenue (Based on Existing Rates)	Inter-Class Cross-Subsidies	Inter-Class Cross-Subsidies (PhP/kWh)	Cross-Subsidy Removal per year for 3-yrs (PhP/kWh)
Sch 25-Residential	112,795,937	495,873	425,681	(70,192)	(0.6223)	(0.1556)
Sch 35-Commercial	48,943,871	188,869	187,150	(1,719)	(0.0351)	(0.0088)
Sch 45-Commercial	98,227,791	352,928	370,769	17,841	0.1816	0.0605
Sch 55-Industrial	54,191,470	167,702	202,346	34,644	0.6393	0.2131
Sch 75-Bulk Power	138,906,918	308,348	337,592	29,244	0.2105	0.0702
Sch 15-Flat Rate	7,157,927	25,768	8,807	(16,961)	(2.3696)	(0.5924)
Other Rev			7,142	7,142		
TOTAL	460,223,914	1,539,488	1,539,488			

I.F. LIFELINE RATE

CEPALCO proposed a rate of PhP3.5999 per kWh excluding Generation and Transmission Charges for its lifeline customers using consumption level of 20 kWh. This is sufficient to cover the consumption of one (1) 32-W fluorescent lamp, one (1) 25-W incandescent lamp, one (1) transistor radio and one (1) 8” desk fan. This reflects the cost of living in the rural areas as well as in the depressed areas of the cities within the CEPALCO’s franchise area. The assumed connected loads as basis for the 20 kWh are as follows:

TABLE 8

Quantity	Type of Load	Watts	kWh/Month
1	Flourescent lamp	32	4
1	Incandescent	25	3
1	Transistor radio		1
1	8” Desk fan		10
		TOTAL	18 ≈ 20

I.G. OTHER CHARGES/NON-RECURRING RATES

CEPALCO has no proposed Other Charges and/or non-recurring charges except to adopt the existing customer charges as approved by the then Board under Case No. 74-138. However, CEPALCO may submit a revised distribution customer services and its charges in appropriate time.

II. COMMISSION'S DISCUSSIONS AND CONCLUSIONS

In reaching the conclusion herein, the Commission took into consideration the documents as well as the comments and issues submitted by the applicant and intervenor who manifested their respective positions on the instant application.

II.A. DETERMINATION OF THE TOTAL REVENUE REQUIREMENT

II.A.1. Test Year

The Commission finds CEPALCO's proposal to use the test year 2000 in its unbundled rate application acceptable since it is consistent with Rule 15 Sec. 6 (c) of the Implementing Rules and Regulations (IRR) of R.A. 9136. Therefore, the discussions and conclusions that follow are based on Schedule B, "Revalued Cost by Function" (Cost of Service by Function – Historical Test Year).

II.A.2. Generation and Transmission Costs

Generation Cost

The Commission updated the generation cost based on the most recent approved NPC rate, *i.e.*, ERC Case No. 2003-574 (In the Matter of the Application for the Recovery of Fuel and Independent Power Producer Costs under the Generation Rate Adjustment Mechanism (GRAM, National Power Corporation (NPC) and Power Sector Assets and Liabilities Management Corporation (PSALM)

– applicants) Order dated January 26, 2004. Notably, the Commission approved the new Generation Charges and the Deferred Accounting Adjustment for Mindanao Grid to be implemented in two years with its rates varying quarterly.

The total purchased power cost (inclusive of fuel), as presented in the amended application amounting to PhP1,045,511,000 was adjusted to reflect the following:

- a) The Commission decided to retain the system loss cap or actual whichever is lower as prescribed under Rule IX Section 1 of the Implementing Rules of Republic Act No. 7832 pending the conduct of a comprehensive study on the matter. Hence, the Commission used CEPALCO's average system loss for the year 2000, 2001 and 2002 which is equivalent to 7.07% and the actual company use of 0.12% for the year 2000.
- b) The Commission also used annualization in calculating the kilowatt-hour purchase power cost. This is calculated as the sum of the products of the average kilowatt-hour consumption for each rate class and the year-end number of customers for each rate class; and
- c) Since power rates are to be applied prospectively, the Commission also updated the composite purchase power cost to the most recent levels available.

Based on the data submitted by CEPALCO to the Commission for the test year period 2000, CEPALCO buys 82% of its power requirement from NPC and 18% from Mindanao Energy Systems (MINERGY). However, the Commission used the most recent generation cost available using the computed supply mix for the February 2004 supply month. Wherefore, CEPALCO buys 96% of its power

requirement from NPC, 1% from MINERGY and 3% from Bubunawan Power Company. The Build-Operate and Own contract of CEPALCO with MINERGY was approved by the previous Board in its Decision dated March 29, 1994 in ERB Case No. 92-229 while the Power Purchase Agreement with Bubunawan Power Company was also approved by the previous Board in its Decision dated January 3, 2001 in ERB Case No. 99-21.

Using the December 2003 supply month, the adjusted purchased power cost amounted to PhP1,361,585,000 for the test year 2000 computed as follows:

TABLE 9

	In Thousand Pesos	
Purchased Power, per CEPALCO	PhP	1,035,810
Fuel		9,701
TOTAL	PhP	1,045,511
Add/(Deduct): Adjustment Increase sales due to Normalization and Power Cost		316,074
Adjusted Purchased Power Cost	PhP	1,361,585

Transmission Cost

The Commission's Decision in ERC Case No. 2001-901 dated June 26, 2002 and Order dated September 20, 2002 set the transmission charges for the TRANSCO without automatic adjustments. Since the transmission rates to be paid by CEPALCO are fixed, it is the decision of the Commission to likewise fix the unbundled transmission rates to be billed to end-users. The transmission charges approved for billing by CEPALCO have been calculated based on the approved TRANSCO rates, which include cross subsidy elements to be phased out over a three-year period.

Based on the new generation and transmission charges, as well as the allowable system loss, the Commission has determined CEPALCO's unbundled generation, transmission and recoverable system loss as follows:

TABLE 10

Particular	Amount
Generation Charge	PhP 876,009
Transmission Charge	387,680
Recoverable System Loss	97,896
TOTAL	PhP 1,361,585

CEPALCO's approved generation charge shall remain fixed until changes in NPC's generation rate are approved and authorized by the Commission pursuant to its Order dated January 26, 2004, ERC Case No. 2003-574 (In the Matter of the Application for the Recovery of Fuel and Independent Power Producer Costs under the Generation Rate Adjustment Mechanism (GRAM), National Power Corporation (NPC) and Power Sector Assets and Liabilities Management Corporation (PSALM) – applicants) and ERC Case No. 2003-498 (ICERA), Order dated December 4, 2003. In view thereof, the Commission does not foresee the need for CEPALCO to continue to implement its Power Cost Charge (PPC) clause. Towards this end, the Commission hereby directs CEPALCO to discontinue the implementation of its Power Cost Charge clause (PPC) upon effectivity of the approved unbundled rates.

II.A.3. Operations and Maintenance (Less Fuel, Power Cost & Payroll)

The general criteria in the evaluation of operating expenses to be allowed for recovery are: 1) that the expense is needed in the operation of the utility; 2) it is recurring; and 3) it redounds to the benefit of the utility's customers (Public Service Commission [PSC] Decision in Case Nos. 85889, 85890 and 89893). The Commission enjoins CEPALCO to incur only "prudent and reasonable costs" for

inclusion in the determination of retail rates. While a distribution utility enjoys the benefit of passing its costs of purchased power and other reasonable costs to the consumer, it is obligated as a public utility to ensure that its costs of operations including payroll are kept at a minimum. The distribution utility must bear in mind that as a service-oriented company, its mandate is to advocate and transact judiciously for and in their behalf of its customers.

“Reasonable costs” refers to the costs of those goods and services which, while may not be the lowest in price, need to be incurred with consideration of quality, efficiency, reliability and security, which are characteristics of the service delivered by the distribution utility. “Prudent costs” demand that the utility ensures that its purchases of goods and services are at their minimum, without sacrificing the foregoing characteristics. When making a purchase or executing a contract, a utility cannot simply rely on its right to pass on its costs to its consumers. As such, the Commission, in fulfilment of the policy of the EPIRA to establish a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency, enjoins CEPALCO to institute and report to the Commission their respective policies and procedures for cost-cutting and the transparent and competitive procurement of goods and services.

CEPALCO’s customers have a right to receive safe, reliable, and adequate service at a reasonable rate. To this end, CEPALCO should view a petition for an increase in rates to be the last recourse. In future filings, CEPALCO should be reminded that it has the burden of proving that all reasonable and appropriate cost cutting measures have been taken before resorting to a petition to increase rates.

The Commission considered the adjustments made by CEPALCO on Operations and Maintenance account amounting to PhP3,387,000. Additional disallowances were made by the Commission amounting to PhP6,720,000 pertaining to expenses deemed to be unnecessary and did not fall under the general criteria set for ratemaking determination and therefore excluded in the determination of revenue requirement. The details of the additional disallowances are shown below:

TABLE 11

Particular	Amount
CEPALCO Adjustments	PhP 3,387,000
ERC Adjustments	
Outside Service	PhP 1,200,000
Property Insurance	5,000
Taxes & Property	395,000
Travel and Transportation	18,000
Customer & Information ^{1/}	3,939,000
Consumer Prompt Payment Discount ^{2/}	62,000
Miscellaneous Expenses	1,101,000
TOTAL ERC	6,720,000
TOTAL ADJUSTMENTS	PhP 10,107,000

^{1/} refers to Bad Debts and Advertising Expenses (see discussion below)

^{2/} see discussion on ORI (p.21)

The Commission excluded from the O&M account – Outside Service – the amount of PhP1,200,000 representing payment on the financial advisory services provided by All Asia Capital to undertake packaging information for CEPALCO in order to promote the utility's image to attract investor and financial advisory fee for the International Financial Corporation (IFC) dollar loan. These expenses are non-recurring in nature, therefore, excluded in the determination of revenue requirement.

The amount of PhP5,000 and PhP395,000, recorded under the accounts Property Insurance and Taxes and Property, respectively, pertain to expenditures corresponding to non-utility assets that were excluded in the rate base determination, hence, the same were excluded in the calculation of revenue requirement.

The Commission also disallowed the expenses amounting to PhP1,101,000, consisting of miscellaneous items in the amount of PhP778,000 and expenses pertaining to non-utility assets amounting to PhP323,000 for failure of CEPALCO to provide documentation.

Travel and transportation expense amounting to PhP18,000 refer to the ocular inspection intended for the Mortgage Trust Indenture which was considered to be a non-recurring expense.

The customer and information expense refer to the uncollectible or bad debts accounts and advertising expenses. CEPALCO made a provision for uncollectible or bad debts amounting to PhP8,840,000 as part of its proposed revenue requirement. Of this amount, 97% accounts for Metro Alloy Corp., (MAC), a 138kV customer which closed its operation in year 1991. The average uncollectible or bad debts for the past three year period covering 1997 to 2000 (excluding 1999 ^{a/}) amounts to PhP4,895,000.

For rate-setting purposes, the Commission did not include the amount of PhP3,945,000 representing the excess amount over the average level of uncollectible or bad debts. On the other hand, the Commission allowed the amount of PhP5,176 which was previously excluded by CEPALCO, because the same pertains to advertising expenses which are informational in nature and necessary in the operation of its electric business. This brings the net adjustment to the Customer and Information account to PhP3,939,000.

^{a/} No actual amount written-off in the year 1999.

For future rate cases, CEPALCO will continue to be required to make full disclosures of all its O & M expenses in order for the Commission to determine the prudence of its expenditures. Unless otherwise justified by CEPALCO, expenses found to be unreasonably incurred shall not be allowed by the Commission as part of its recoverable costs to be passed on to CEPALCO's end-users.

II.A.4. Income Tax

The finality of the Supreme Court Decision on G.R. Nos. 141314 and 141369 dated April 9, 2003 affirms that for ratemaking purposes under the RORB methodology, income tax payment should not be recovered from customers as operating cost.

In view of the above, income taxes in the amount of PhP16,268,000 was excluded from CEPALCO's revenue requirement.

CEPALCO has an existing "Tax Adjustment Clause", which was approved under ERB Case No. 93-49 in its Decision dated February 4, 1994, wherein the formula was designed to recover income tax and franchise tax (in excess of the 2.75% paid to the national and local government). Although CEPALCO did not implement the aforesaid Tax Adjustment Clause since its approval, it was however implemented last December 2003. Henceforth, CEPALCO, upon the effectivity of this Decision, is hereby directed to no longer implement the same.

II.A.5. Franchise Tax

There will be a separate line to reflect the franchise tax wherein this will be computed based on distribution, supply and metering charges, and other charges/adjustments such as Inter-class Cross Subsidy, Lifeline discount and

CERA, in this case. Thus, franchise tax amounting to PhP36,133,000 was excluded in the revenue requirement.

II.A.6. Depreciation and Amortization Expense

The Commission further adjusted the depreciation expense downward by PhP4,798,000 corresponding to the depreciation of the assets that are disallowed in the rate base for being not used or useful at the time of the application and the corresponding 5% overvaluation on the appraisal increment.

II.A.7. Depreciation Fund

CEPALCO is required to set up a depreciation fund each year corresponding to the whole amount of depreciation that it has recorded on its books. The setting up of this fund should be done on a monthly basis corresponding to the monthly depreciation. CEPALCO will be required to strictly account for the expenditures out of this fund which should be solely for investment in electric plant. The utility is free to withdraw funds from this account at any time but all withdrawals should be reported to the Commission within thirty (30) days specifying the use of funds. This report should be consolidated with the monthly reportorial requirements (M-001 & M-002).

II.B. Other Revenue Items

The Commission considered Other Revenue as items to be deducted from the revenue requirement used to calculate the rates for the end-users. Since all the expenses associated with the provision of the services that gave rise to these items of revenue are included in the revenue requirement, the income generated must also be considered, to wit:

TABLE 12

Other Revenue Items	In Thousand Pesos	
Service Fees (Service connection, Reconnection, etc)	PhP	204
Rental for Distribution Transformers		291
Rental for Poles, Boom Truck and Crane		5,856
Testing and Calibration Fees		1
Sale of Scrap Materials		45
Others		744
Sub-Total Other Revenue Items	PhP	7,142
Add: PPD from NPC & Minergy (Net of PPD to CEPALCO customers)		413
Total Other Revenue Items	PhP	7,555

II.B.1 Prompt Payment Discount

CEPALCO included in its revenue requirement a prompt payment discount (PPD) amounting to PhP62,000. The Commission believes that the utility and end-users should share the benefits of the prompt payment discount (PPD) received by CEPALCO from NPC and MINERGY amounting to PhP28,110,000. In this case, CEPALCO is also giving prompt payment discount to its customers amounting to PhP27,284,000, hence, fifty percent (50%) of the net discount equivalent to PhP413,000 should be deducted from the revenue requirement used to calculate the rates for the end-users and fifty percent retained by the utility to serve as incentive to improve efficiency in the payments of its purchased power cost, computed as follows:

TABLE 13

Prompt Payment Discount	Amount
PPD Discount from NPC and Minergy	PhP 28,110,000
Less: CEPALCO PPD to customers	27,284,000
Net PPD	826,000
50% thereof	PhP 413,000

II.C. RATE BASE

II.C.1. Assets Valuation

The Commission adjusted the assets in the Appraisal Report as of December 31, 1999 by deducting assets which were found to be not used or

useful in the operation of its business and the substation which is not yet operational at the time of evaluation of the case. Utility plant additions subsequent to the last appraisal are reflected at costs.

II.C.2. Summary of Net Plant in Service

The Commission has determined CEPALCO's net plant in service as of December 31, 2000 considered in this case as follows:

TABLE 14

Particular	In Thousand Pesos				
	Total Company	Non-Electric	Adjusted Electric	ERC Adjustment ^{1/}	ERC Adj. Balance
Distribution Plant	1,569,652	-	1,569,652	(73,032)	1,496,620
General Plant	376,377	(127,775)	248,602	(53,435)	195,167
Total Plant in Service	1,946,029	(127,775)	1,818,254	(126,467)	1,691,787
Less: Accumulated Depreciation					
Distribution Plant	(420,379)	-	(420,379)	-	(420,379)
General Plant	(73,406)	-	(73,406)	-	(73,406)
Total	(493,785)	-	(493,785)	-	(493,785)
Net Plant in Service	1,452,244	(127,775)	1,324,469	(126,467)	1,198,002
Construction Work in Progress (CWIP)	113,711	-	113,711	(113,711)	-
Net Plant in Service (incl. CWIP)	1,565,955	(127,775)	1,438,180	(240,178)	1,198,002

^{1/} inclusive of 5% allowance for overvaluation on appraisal increment

Per CEPALCO's application, net plant in service is inclusive of Construction Work in Progress (CWIP)

The Commission made a downward adjustment pertaining to assets not being used or utilized in the operation of its business amounting to PhP126,467,000, inclusive of 5% allowance for overvaluation on appraisal increment amounting to PhP33,032,000, details as follows:

TABLE 15

Distribution Plant	Amount
Land and Land Rights	
Tablon Property (Adjusted to consider Site II)	PhP (15,052,000)
J. Pacana (re-classify from General Plant)	8,534,000
Pueblo de Oro (re-classify from General Plant)	7,500,000
Sub-total	982,000
Depreciable Assets	
Station Equipment	43,437,000
5% allowance for overvaluation on Appraisal Increment	28,613,000
TOTAL	PhP 73,032,000

General Plant	
Land & Land Rights	
J. Pacana	PhP (8,534,000)
Tablon Property (per CEPALCO-Appraisal Increase)	44,468,000
Old National Road (a non-utility asset)	6,000,000
Portion of 33 Chavez (disallowed portion offered for rent)	800,000
Sub-Total	42,734,000
Depreciable Assets	
Structures & Improvements	4,389,000
Office Furniture	211,000
Transportation & Equipment	1,639,000
Tools, Shop & Garage	43,000
Sub-Total	6,282,000
5% allowance for overvaluation on Appraisal Increment	4,419,000
TOTAL	PhP 53,435,000
GRAND TOTAL	PHP 126,467,000

Both the Tablon (portion only) and Monteverde mansion properties were excluded in the calculation of CEPALCO's net plant in service.

CEPALCO manifested that only site II of the Tablon property is being utilized as warehouse and pole yard. On the other hand, the Monteverde Mansion located in San Juan is being used by CEPALCO as staff house yet CEPALCO's business operation is in Cagayan de Oro City.

II.C.3. Construction Work in Progress (CWIP)

The total CWIP included in this application of CEPALCO amounts to PhP113,711,000. Based on the records of the case, said amount is inclusive of the project Macasandig Substation which has no prior approval from the previous Board for construction. Further, as of December 2003, said substation is not yet operational, thus, the amount representing the cost of the substation amounting to PhP30,549,000 was excluded as part of the rate base. The balance of PhP83,162,000 pertains to the CWIP completed and in service as of December 2003.

II.C.4. Allowance for Cash Working Capital

Working capital is money a business must have available to meet payroll and expenses until customers have paid for the service or product. Utilities are usually allowed, as part of their rate base, an amount for working capital to cover expenses during the time it takes for the customers to use the service, be billed for it and collect payments.

CEPALCO has included an amount equal to two (2) months cash operating and maintenance expenses including purchased power costs as the estimated allowance for cash working capital.

The cash working capital allowance included in the rate base should approximate the cash requirements of CEPALCO based on an estimated net lag in its cash flow. In order to refine the application of the formula used in past proceedings, a more detailed review of the actual lag in cash flow associated with the payments for purchased power and the inflow of cash from CEPALCO's customers was undertaken. With respect to the outflow of cash associated with the payments for purchased power, it was determined that the time from the provision of service to the outflow of funds can be calculated as follows:

15 days	One-half of the billing cycle
5 days	Meter reading and bill preparations
<u>10 days</u>	Approximate time before payment is due
<u>30 days</u>	Total

Therefore, CEPALCO has an average of approximately 30 days from the time service is received until payment is due.

With respect to the collection of funds from its customers, it was determined that the time lag from the provision of service to the inflow of funds can be calculated as follows:

15 days	One half of the billing cycle
5 days	Meter reading and bill preparation
11 days	Required time to collect the customer's bill without penalty based on the service contract
<u>5 days</u>	Processing time
<u>36 days</u>	Total

Therefore, CEPALCO waits for an average of approximately 36 days before it receives payment for the services provided. With respect to purchased power, it appears that the actual net lag days is approximately six (6) days only (36 less 30) and not the sixty (60) days assumed in CEPALCO's application of the formula. CEPALCO's customers who do pay on time should not be penalized because other customers fail to comply with CEPALCO's payment schedule. If additional finance costs are incurred because of late payment of bills, these costs should be recovered in the form of penalties to the late paying customers and not as additional cash working capital to be paid by all customers.

The adjusted Cash Working Capital (CWC) allowed by the Commission was computed as follows:

TABLE 16

Particular	In Thousand in Pesos		
	CEPALCO	Adjustments	ERC
O & M ^{a/}	1,291,221	(1,057,030)	234,191
Less: Taxes & Non-cash items			
Depreciation	(122,540)	(4,798)	(117,742)
Property Taxes	(2,127)	(395)	(1,732)
Allowance for Bad Debts	-	4,895	(4,895)
Supervision or Regulatory Fees	(2,350)	(2,350)	-
Total	(127,017)	(2,648)	(124,369)
Net O & M Subject for CWC	1,164,204	(1,054,382)	109,822
PPC inclusive of Fuel	-	-	1,361,585
Computation for Cash Working Capital			
CWC for O&M (2/12 thereon)	194,034		18,304
CWC for PPC (6/360 days)			22,693
TOTAL Cash Working Capital	194,034	(153,037)	40,997

^{a/} CEPALCO's O & M is inclusive of purchased power cost (PPC), payroll, O & M and Depreciation
ERC O & M is net of PPC and Franchise Requirement and Regulatory Fees

II.C.5 Materials and Supply

CEPALCO did not include any amount of Materials and Supplies in its Rate Base. The Commission believes that the reported materials and supplies in the amount of PhP27,293,000, per book, must be included in the determination of rate base considering that these represents electrical materials and supplies that are essential in providing electricity supply.

II.C.6. Summary of Rate Base

The following tabulates the components of CEPALCO's rate base approved by the Commission:

TABLE 17

Particular	In Thousand Pesos				
	Total Company	Non-Electric	Adjusted Electric	ERC Adj	ERC Adj. Balance
Net Plant in Service	1,452,244	(127,775)	1,324,469	(126,467)	1,198,002
Add/(Deduct):					
Construction Work in Progress	113,711	-	113,711	(30,549)	83,162
Materials & Supplies		-		27,293	27,293
Cash Working Capital	194,580	(546)	194,034	(153,037)	40,997
TOTAL RATE BASE	1,760,535	(128,321)	1,632,214	(282,760)	1,349,454

II.C.7. Rate of Return

The current form of rate regulation practiced for the privately owned electric utilities is a cost based method known as the rate of return on rate base (RORB) methodology. Power rates are set to recover cost of service prudently incurred plus a reasonable rate of return on rate base. The rate of return pertains to the percentage which multiplied by the authorized Rate Base, provides a return that will fairly compensate the company for the risk inherent to the investment of capital. This simply means that a regulated utility is allowed to set rates which will cover operating costs and provide an opportunity to earn a reasonable rate of return on the assets utilized in the business.

On the basis of current jurisprudence, the Commission has determined that the 12% rate of return will be maintained in this case but the income tax thereon will not be allowed as operating expense. Thus, the 12% rate of return is a pre-tax rate of return which is equivalent to PhP161,934,000, computed as follows:

TABLE 18

Particular	In Thousand Pesos		
	Per Company	Adj.	ERC Adj. Balance
Total Rate Base	1,632,214	(282,760)	1,349,454
Rate of Return	12%		12%
Return on Rate Base	195,866	(33,932)	161,934

The Commission intends to adopt a new internationally accepted method of regulation such as Performance-Based Regulation. The treatment of income tax in this new method may be different from the present RORB method.

II.E. Revenue Requirement Summary

On the basis of the foregoing discussion, the proposed revenue requirement as reflected in the following table was adjusted upward by PhP1,750,156,000.

TABLE 19

Particular	In Thousand Pesos				
	Total Company	Non-Electric	Adjusted Electric	ERC Adj.	ERC Adj. Balance
Purchased Power (incl. of fuel)	1,045,511	0	1,045,511	316,074	1,361,585
Payroll	44,034	0	44,034	0	44,034
Operation & Maintenance	82,523	(3,387)	79,136	(6,720)	72,416
Depreciation & Amortization	125,143	(2,603)	122,540	(4,798)	117,742
Income Taxes	16,268	0	16,268	(16,268)	0
Other Expenses (Fran. Tax)	36,133	0	36,133	(36,133)	0
Return on Rate Base	211,264	(15,398)	195,866	(33,932)	161,934
Less: Other Revenue Items	0	0	0	(7,555)	(7,555)
TOTAL REV. REQUIREMENT	1,560,876	(21,388)	1,539,488	210,668	1,750,156
Adj. Existing Revenue (2000)					1,705,646
Increase/(Decrease)					44,510
Annualized kWh Sales					483,111
Required Inc./(Dec.) P/kWh					0.0921

The overall average tariff adjustment (OATA) is a measurement tool based on the formula: (Total Revenue Requirement less Existing Revenue divided by

kilowatt-hours sales). This measurement is not meant to refer to any specific customer class. CEPALCO proposed for an OATA of PhP0.39 per kilowatt-hour while the Commission's computed OATA is PhP0.0921 per kWh pertaining to distribution charges (distribution, supply and metering charges).

II.F. Adjusted Operating Revenue

The Commission adjusted CEPALCO's existing operating revenue to PhP1,705,646,000 computed as follows:

TABLE 20

Particular	In Thousand Pesos
Revenue Requirement	PhP 1,407,806
Add/(Deduct): Adjustments	
Add'l revenue due to increase in sales and increase in power cost	344,745
Franchise Tax, 2.75%	(46,905)
Adjusted Existing Revenue	PhP 1,705,646

II. G. Functionalization Factors

The Commission agrees to the functionalization and allocation factors used by CEPALCO. Other Revenue Items which was not considered by CEPALCO in the calculation of the revenue requirement was functionalized to Distribution function and was allocated based on the total revenue functionalization factors.

II. H. Billing Determinant and Customer Class Allocation

The Commission concurs with CEPALCO's billing determinant and allocation factors except for the billing determinant and allocation factor used for energy related costs. The Commission believes that any energy related cost should be allocated based on annualized sales.

Annualized sales were derived by multiplying year-end number of customers with average annual kWh usage for each customer class. This was performed to project for the future kWh sales for the development of a more appropriate allocation factors and billing determinants for each customer class. With the annualized sales per customer class, the computed adjusted kilowatt-hour sold was 483,111,000.

The Commission opines that in theory, the most appropriate way to allocate costs among customer classes is through the use of the cost causation principles. Thus, the Commission intends, through proceedings to move even further towards uniform definition of customer classes based on cost causation characteristics. However, the Commission believes that such a change would best be accomplished through the issuance of guidelines of a general applicability to all utilities. Furthermore, R.A. 9136 requires the identification and removal of interclass cross-subsidies. Substantive change in customer classes at this time prevents precise calculation of cross-subsidy in existing rates. Therefore, no changes in customer class allocations are ordered for CEPALCO at this time.

II.I. Design and Calculation of Charges

II.I.1 Generation Charge

The Commission updated the generation cost based on the most recent approved NPC rate, i.e., ERC Case No. 2003-574, Order dated January 26, 2004. Notably, the Commission approved the adoption of the Incremental Currency Exchange Rate Adjustment (ICERA) under ERC Case NO. 2003-498, Order dated December 4, 2003 (NPC & PSALM – applicants). The Commission directed NPC and PSALM to refund to its customer the Deferred Accounting Adjustment (DAA)

and FOREX Correction for Mindanao amounting to PhP1.1283 per kWh within a period of six months starting December 2003 to May 2004.

The NPC's approved rate will remain fixed until changes are authorized by the Commission. This eliminates the used for future Purchased Power Adjustment.

The Commission has developed a new recovery mechanism designed to replace the purchased power adjustment clauses being used by the power utilities. The Commission has promulgated the Implementing Guidelines on Generation Rate Adjustment Mechanism (GRAM) effective February 24, 2003. In view thereof, the Commission does not foresee the need for the Purchased Power Adjustment (PPA) clause. Towards this end, the Commission hereby directs CEPALCO to discontinue implementation of its Power Cost Charge (PCC) clause upon effectivity of the approved unbundled rates.

Further, the Commission has developed a generation rate for its Bulk Power customers since during power outage or deficiency in the supply of power from NPC, these customers were cut-off from CEPALCO distribution system, hence, do not enjoy the supply of electricity coming from Minergy.

II.I.2. Transmission Charge

The Commission's decision in ERC Case No. 2001-901 and Commission's Order dated September 20, 2002 fixed the transmission charges for the National Transmission Corporation (TRANSCO) without any provision for automatic adjustment thereof. Since the transmission rates to be paid by CEPALCO are

fixed, it is the decision of the Commission to likewise fix the unbundled transmission rates billed to its end-use customers.

The transmission charge shall be billed in a fixed rate per kilowatt-hour for Residential – Schedule 26, Commercial – Schedule 36, Commercial – Schedule 46, Schedule 16 – Flat Rate/Streetlights end-users. In the case of Industrial – Schedule 56, and Bulk Power – Schedule 76 customers, the transmission charge shall be billed using a fixed rate per kilowatt (kW).

In consonance with the gradual phase-out of the intra-grid subsidies being billed by TRANSCO, the Commission hereby sets the transmission charges for the succeeding years, as follows:

TABLE 21

TransmissionCharges	Residential Sched.26	Commercial Sched.36	Commercial Sched.46	Industrial Sched.56	Bulk Power Sched.76	Flat rate Sched.16
Year 2 (Sept. 26, 2003 – Sept. 25, 2004)						
Demand (Php/kW)	-	-	-	356.26	447.46	-
Trans. Sys. Charge (PhP/kWh)	0.8265	0.8140	0.8306	-	-	0.8012
Year 3 (Sept. 26, 2004 – Sept. 25, 2005)						
Demand (Php/kW)	-	-	-	346.34	435.00	-
Trans. Sys. Charge (PhP/kWh)	0.8035	0.7913	0.8075	-	-	0.7789
Year 4 (Sept. 26, 2005 - Sept. 25, 2006)						
Demand (Php/kW)	-	-	-	336.43	422.55	-
Trans. Sys. Charge (PhP/kWh)	0.7805	0.7687	0.7844	-	-	0.7566

II.I.3. System Loss Charge

The Commission defines System Loss for utilities to include technical loss and administrative loss or the utility's use of power for its own operations.

The Commission approves the recovery of allowed system loss though the establishment of a separate System Loss Charge. The system loss charge shall vary from one customer class to another depending on their respective contributions to the system loss. The allowed system loss is equal to the actual

system loss for the rest or the existing system loss cap prescribed in R.A. 7832 whichever is lower.

The allowed system loss for this case is equal to the average system loss for the year 2000, 2001, and 2002. The Commission, in arriving at this Decision, recognizes that the distribution utility faces some risk of over- or under-recovery in the event its load characteristics change through time. The system loss not only results in additional unbundled generation costs but also additional unbundled transmission costs to be paid by end-users. When system loss is within allowable cap, the distribution utility shall recover from the end-users all generation and transmission costs. Thus, system loss in excess of the allowable caps shall not be recovered from the end-users.

II.I.4. Distribution Charge

The distribution charge shall be billed on a fixed rate per kilowatt-hour for Residential – Schedule 26, Commercial – Schedule 36, Commercial – Schedule 46 and Flat Rate/Street Lights end-users. In the case of Industrial – Schedule 56, and Schedule 76 – Bulk Power customers with demand meters, the distribution charge shall be billed using a fixed rate per kilowatt (kW).

Relevant to distribution charge, CEPALCO proposed for distribution wheeling rates comprising of its proposed distribution and supply charges. The Commission believes that wheeling rates are parallel to the cost of service functionalized under Distribution. Thus, the Commission orders that the Distribution Charge provided on Rate Schedules be likewise utilized as Distribution Wheeling Charges available to the future contestable market.

The Commission's decision to allow a distribution utility to avail of the Distribution Wheeling Charges of another distribution utility is based on general intent of R.A. 9136 to promote a competitive generation market. Distribution utilities that currently or in the near future rely in full or in part on the distribution facilities of another distribution utility should not be held captive by the other distribution utility in the purchase of unbundled generation. Distribution utilities are, therefore, prohibited from bundling or tying the sale of generation or purchased power with the sale of unbundled distribution wheeling service.

II.I.5. Metering and Supply Charges

The Commission acknowledges that cost-causation rate design principles suggests the recovery of customer-related costs through fixed monthly charges. In addition to this cost of service principle, however, the Commission must also consider rate design impacts across the spectrum of customers within each rate class. Although RA 9136 requires the removal of inter-class cross subsidies, the law does not require removal of intra-class cross-subsidies. The Commission has the flexibility to consider other factors in determining rate design for a particular class of customers. Therefore to mitigate the impact on below-average consumption of residential end-users, the Commission orders CEPALCO to use a combination of a PHP5.00 peso per customer per month and peso per kilowatt-hour for the metering function for residential customers. All other end-users shall be charged fixed monthly customer charge. On the other hand, the Commission orders CEPALCO to use peso per kilowatt-hour rate for Residential, Commercial and Street Lighting customers for the supply function while Industrial and Bulk Power customers shall be charged fixed monthly customer charge.

II.I.6. Franchise Taxes

Franchise taxes shall appear as a separate line item on the customers' bills. Given this rate design, it is appropriate to remove test year amounts associated with franchise taxes from the revenue requirement used to calculate other recurring electricity rates.

CEPALCO is directed to use the formula below in calculating its franchise taxes.

Franchise Tax:

$$\text{Distribution, Supply and Metering Revenue, Other Charges/Adjustments} \times FT_{x,y}$$

Where: FT_x = National franchise tax of 2%
 FT_y = Applicable local franchise tax

II.J. Cross Subsidy Removal

The inter-class cross subsidies in existing rates are as follows:

TABLE 22

	In Thousand Pesos						
	TOTAL	Residential Sched. 26	Commercial Sched. 36	Commercial Sched. 46	Industrial Sched. 56	Bulk Power Sched. 76	Flat rate Sched. 16
New Cost-Based Revenue	1,750,156	542,454	230,563	159,736	395,764	393,518	28,122
Existing Rates Revenue	1,705,646	441,090	195,668	165,775	439,918	434,679	28,516
Total Change in Revenue	44,510	101,363	34,895	(6,039)	(44,154)	(41,161)	(394)
% Change in Rev.	3%						
Normalized Rev.	1,750,156	452,601	200,774	170,101	451,398	446,022	29,260
Inter-class Cross Subsidy Amounts	-	(89,853)	(29,789)	10,365	55,634	52,504	1,138
Class Billing Determinant(kWh)	483,111	114,966	50,650	42,745	114,232	152,993	7,525
Inter-class Cross Subsidy Rates (Php/kWh)		(0.7816)	(0.5881)	0.2425	0.4870	0.3432	0.1512

Section 74 of R.A. 9136 and Rule 16, Section 5 of the Implementing Rules and Regulations thereof provide that ERC shall issue a scheme for phasing out all

cross subsidies including subsidies within Grids, between Grids, and between classes of end-users. The phasing out period shall not exceed three (3) years from the establishment of the Universal Charge which may be extendible for a maximum period of one (1) year subject to certain conditions.

The Commission approved the cross subsidy removal scheme for the TRANSCO in its Decision dated June 26, 2002, Case No. 2001-901 which impacts the unbundled transmission rates for CEPALCO's end users. This impact is reflected in the three-year schedule for unbundled transmission charges provided in Section II.I.2 above.

In the instant case, the Commission will order the cross subsidy removal process at a later date following the establishment of the Universal Charge. Until such time, CEPALCO will continue to charge the inter-class cross subsidy rates set forth above.

II.K. Lifeline Rate

Section 4 (hh) of R.A. 9136 defines Lifeline Rate as the subsidized rate given to low-income captive market end-users who cannot afford to pay at full cost. Pursuant to Section 73 of R.A. 9136, the Commission hereby sets the level of lifeline consumption and rate applicable to CEPALCO.

In determining the lifeline level of consumption to be provided to the marginalized end-users, the Commission calculated the probable load requirement of typical low-income consumers by two (2) lighting facilities at 20 watts each and a 50-Watt Radio that are being used for a reasonable number of hours. Thus, the Commission sets the Lifeline consumption maximum level of 100 kilowatt-hours for

CEPALCO. The Commission considers the impact that the subsidized Lifeline Rates will have on other end-users who must carry the costs associated with such subsidy. This fact combined with the desire to maximize the benefit to as many marginalized end-users as possible has led the Commission to adopt the following graduated scale for lifeline discount for CEPALCO. The graduated scale is also based on the recognition that individual end-user consumption may likely vary from month to month.

TABLE 23

Consumption Level	Discount (in %)
0-20 kWh	50
21-30	45
31-40	40
41-50	40
51-60	35
61-70	30
71-80	30
81-90	25
91-100	20

CEPALCO shall apply these discounts to the following residential charges: Generation, Transmission, Distribution, Supply, Metering and System Loss. In a given billing period, an end-user at any of the above-consumption levels shall be given the specified corresponding discount on each of these rate components. An end-user with a level of consumption exceeding 100 kWh in a particular billing period shall not be entitled to any discounted lifeline rate for said period.

The cost of subsidy to lifeline end-users shall be passed on to all non-lifeline end users. For CEPALCO, the lifeline discounts result in a Subsidy on Lifeline by other end-users equal to PhP0.0507/kWh.

II.L. Other Charges

The Other Charges of CEPALCO are hereby pegged at their existing levels until such time that the Commission sets new rates on the same. Further, CEPALCO is ordered to make a compliance filing on its Other Charges a year from the date of this Decision using a format to be prescribed by the Commission.

The compliance filing for approval of Other Charges shall include rates that are cost-based as well as all supporting cost justification for the rates, including but not limited to the amount of actual time and wages of employees performing each task encompassed by each type of Other Charges.

II.M. Estimated Impact On Average Residential Consumer

A comparison of the estimated impact of all adjustments on the revenue requirement on the monthly bill of a residential end-user consuming 154 kWh a month using rates based on CEPALCO's actual existing bundled rates as of February 2004 against the unbundled rates approved by the Commission is shown below.

TABLE 24

RESIDENTIAL Consuming 154 kWh	Peso/kWh	Amount		Peso/kWh	Amount
Basic Charge			Generation Charge	1.9932	306.95
1 st 15 Kwh	12.45/mo	12.45	Transmission Charge	0.8265	127.28
Excess kWh	0.83	115.37	System Loss Charge	0.2099	32.32
PCC	2.9739	457.98	Distribution Charge	0.8622	132.78
Power Act Reduction	(0.2610)	(40.19)	Supply Charge	0.5434	83.69
CERA	0.0600	9.24	Metering Charge:		
Universal Charge			Retail Customer Charge/Mo.		5.00
Environmental Charge	0.0025	0.39	Metering System Charge	0.2496	38.44
Missionary Electrification	0.0373	5.74	Sub-Total		726.46
			Lifeline Discount	-	-
			Lifeline Rate Subsidy	0.0507	7.81
			Inter-Class Cross Subsidy	(0.7816)	(120.36)
			Power Act Reduction	(0.2610)	(40.19)
			CERA	0.0600	9.24
			Sub-Total		(143.50)
			National & Local Franchise Tax	2.75%	4.31
			Universal Charge	0.0398	6.13
TOTAL BILL		560.97			593.40
Ave. Rate/kWh		3.64			3.85
Inc/(Dec) in Rates (PhP/kWh)					0.21
Inc./(Dec) in Bill (Pesos)					PhP32.43

Note: Franchise tax was computed based on the distribution charges, i.e., Distribution, Supply, Metering, Inter-class Cross Subsidy, Lifeline discount, CERA.

DISPOSITION

WHEREFORE, the foregoing premises considered, it is hereby decided as follows:

1. To approve the unbundled schedule of rates of CEPALCO, to be effective the first billing cycle thirty (30) days after receipt of this Decision, to wit;

CAGAYAN ELECTRIC LIGHT & POWER CO., INC.
ERC CASE No. 2001-892
RATE SCHEDULE

CUSTOMER CLASS	Generation	Transmission		Distribution		Supply		Metering		System Loss	Lifeline Rate Subsidy	Inter-Class Cross Subsidy	Universal Charge	
		P/kWh	P/kW	P/kWh	P/kW	P/kWh	P/cust/mo	P/kWh	P/cust/mo				P/kWh	P/kWh
Sch 26-Residential														
Lifeline(0-100 kWh)	1.9932	0.8265		0.8622		0.5434		0.2496	5.00	0.2099	-	(0.7816)	0.0373	0.0025
Over 100 kWh	1.9932	0.8265	-	0.8622	-	0.5434	-	0.2496	5.00	0.2099	0.0507	(0.7816)	0.0373	0.0025
Sch 36-Commercial	1.9932	0.8140	-	0.6573	-	0.2781	-	-	197.92	0.2099	0.0507	(0.5881)	0.0373	0.0025
Sch 46-Commercial	1.9932	0.8306	-	0.5705	-	0.0425	-	-	197.92	0.2084	0.0507	0.2425	0.0373	0.0025
Sch 56-Industrial	1.9932	-	356.26	-	186.44	-	119.01	-	583.19	0.2084	0.0507	0.4870	0.0373	0.0025
Sch 76-Bulk Power	1.4251	-	447.46	-	112.90	-	119.01	-	583.19	0.1886	0.0507	0.3432	0.0373	0.0025
Sch 16-Flat Rate	1.9932	0.8012	-	0.7302	-	0.0052	-	-	-	0.2071	0.0507	0.1512	0.0373	0.0025

Note: Plus CERA, National and Local Franchise Tax

2. To approve CEPALCO's adjusted rate base as of December 31, 2000 from PhP1,760,535,000 to PhP1,349,454,000; and
3. To direct CEPALCO to comply with the following:
 - a) Discontinue charging the PCC upon effectivity of the approved unbundled rates; any change in the cost of power purchased shall be reflected as deferred charges or credits which shall be recovered in accordance with a recovery mechanism prescribed by the Commission;

- b) Discontinue charging the "Tax Adjustment Clause" upon the effectivity of the approved unbundled rates and hereby directed to submit xerox copy of receipts paid to the local franchise tax from year 1994-2003;
- c) Bill its respective end-users using a bill format which contains at the least rate elements provided in Annex "A" (Rate Schedule) of this Decision upon effectivity of the approved unbundled rates;
- d) Bill its respective end-users using a billing format which contains at least the rate elements provided in Annex "B" of this Decision upon effectivity of the approved unbundled rates. The rate element provided herein should appear on the end-users' bill even if the rate elements currently have zero (0) or have not yet been determined by the Commission;
- e) Make a formal application to continue the use of Other Charges within one (1) year from date of this Decision using a format to be prescribed by the Commission;
- f) Bill the amount P0.0373/kWh representing the missionary electrification portion of the Universal Charge in accordance with the Decision of the Commission in ERC Case No. 2001-165 (In the Matter of the Petition for the Availments from the Universal Charge the Share for Missionary Electrification, NPC-SPUG, Applicant);
- g) Bill the amount P0.0025/kWh representing the environmental portion of the Universal Charge in accordance with the Commission's Decision in ERC Case No. 2002-194 (In the Matter of the Petition for the Availment from the Universal Charge the Environmental Share/Charge for the Rehabilitation and Management of Watershed Areas, NPC, Applicant);
- h) Set up a depreciation fund each year corresponding to the whole amount of depreciation that it has recorded on its books. The setting up of this fund should be done on a monthly basis corresponding to the monthly depreciation. CEPALCO is required to strictly account for the expenditures out of this fund which should be used strictly for investment in electric plant

and all withdrawals from this fund should be reported to the Commission within thirty (30) days from withdrawal;

- i) Inform the end-users within its franchise area of the approved unbundled rates not later than thirty (30) days after receipt of this Decision;
- j) Submit for verification and confirmation purposes on or before the twentieth (20th) day of the month following the effectivity of the approved unbundled rates and every month thereafter: a) five (5) sample bills for each customer class; b) copy of bills from the generation and transmission companies ; and c) M-001 and M-002 with all related schedules;

SO ORDERED.

Pasig City. May 19, 2004.

RODOLFO B. ALBANO, JR.
Chairman

OLIVER B. BUTALID
Commissioner

CARLOS R. ALINDADA
Commissioner

LETICIA V. IBAY
Commissioner

JESUS N. ALCORDO
Commissioner

Copy furnished:

- 1. Office of the Solicitor General**
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- 2. Commission on Audit**
Diliman, Quezon City
- 3. House Committee on Energy**
Batasan Hills, Quezon City
- 4. Senate Committee on Energy**
GSIS Building, Roxas Boulevard
Pasay City 1307
- 5. The City Mayor**
Cagayan de Oro City 9000
- 6. The Municipal Mayor**
Tagoloan, Misamis Oriental 9001
- 7. The Municipal Mayor**
Villanueva, Misamis Oriental 9002
- 8. The Municipal Mayor**
Jasaan, Misamis Oriental 9003
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