

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



**IN THE MATTER OF THE
APPLICATION FOR
APPROVAL OF THE ENERGY
SUPPLY CONTRACT (ESC)
ENTERED INTO BY AND
BETWEEN ILOCOS NORTE
ELECTRIC COOPERATIVE,
INCORPORATED (INEC)
AND SAN MIGUEL ENERGY
CORPORATION (SMEC),
WITH PRAYER FOR
PROVISIONAL AUTHORITY,**

ERC CASE NO. 2012-079 RC

**ILOCOS NORTE ELECTRIC
COOPERATIVE,
INCORPORATED (INEC)
AND SAN MIGUEL ENERGY
CORPORATION (SMEC),
Applicants.**

X ----- X

D O C K E T E D
Date: AUG 31 2017
By: [Signature]

DECISION

Before the Commission for resolution is the application filed on June 18, 2012 by Ilocos Norte Electric Cooperative, Incorporated (INEC) and San Miguel Energy Corporation (SMEC) for approval of their Energy Supply Contract (ESC), with prayer for provisional authority.

In the said Application, INEC and SMEC alleged, among others, the following:

Parties to the ESC

1. INEC is an electric cooperative duly organized and existing under and by virtue of the laws of the Republic of the Philippines with principal office address at Suyo, Dingras, Ilocos Norte. It holds a franchise to operate a light and power service in the Municipalities of Adams, Bacarra, Badoc, Bangui, Banna, Burgos, Carasi, Currimao, Dingras, Dumalneg, Marcos, Nueva Era, Pagudpud, Paoay, Pasuquin,

Piddig, Pinili, San Nicolas, Sarrat, Solsona, Vintar, and the Cities of Laoag and Batac, all in the Province of Ilocos Norte (Franchise Area);

2. SMEC is a domestic corporation organized and existing under the laws of the Philippines, and is primarily engaged in the generation of electricity, with principal office address at 2nd Floor, 808 Building, MERALCO Avenue corner General Lim St., San Antonio Village, Pasig City;

Statement of Facts

3. INEC and the National Power Corporation (NPC) executed a Contract for the Supply of Electric Energy (CSEE) which was assigned to SMEC by the Power Sector Assets and Liabilities Management Corporation (PSALM);
4. In 2010, they executed an ESC (1st ESC) with a term of one (1) year or from July 26, 2010 to July 25, 2011. On March 1, 2011, by virtue of a Letter of Agreement, they amended the said 1st ESC and extended it until December 25, 2011;
5. In view of the expiration of the foregoing 1st ESC, INEC, through its Bids and Awards Committee (BAC), conducted a selection process for the purpose of selecting a power generator that can supply its electricity requirements at the lowest electricity rates and other favorable contractual provisions that would benefit it and its member-consumers;
6. On October 5, 2011, INEC published an Invitation for Eligibility and to Bid through the Classified Ads of the Philippine Daily Inquirer;
7. On October 12, 2011 or the last day set by INEC for the submission of the Letter of Intent, only SMEC signified its intention to participate in the bidding process. On October 14, 2011, the Chairman of the BAC declared that there was a failure of bidding considering that less than three (3) bidders were received;
8. Subsequently, on October 17, 2011, AES Philippines submitted its proposal for the supply of INEC's electric requirements. On October 26, 2011, GN Power also submitted its belated bid. Since there was already a declaration of failure of bidding, the belated bids were merely accepted but no further bidding was held;
9. Due to the forthcoming expiration of the 1st ESC on December 25, 2011, INEC negotiated with SMEC for renewal of the same;
10. On October 21, 2011, after a determination that the proposal of SMEC is reasonable and advantageous to INEC and its member-consumers, it awarded the supply of its electricity requirements to SMEC;

11. Subsequently, they executed their second (2nd) ESC with a term of five (5) years or from December 26, 2011 to December 25, 2016;
12. Under the said 2nd ESC, SMEC shall impose the agreed Basic Energy Rate expressed in the Time-of-Use (TOU) hourly rate (in P/kWh) as provided in the table below:

BER in TOU, PhP/kWh
(December 26, 2011 to December 25, 2016)

Period	January to June		July to December	
	Monday to Saturday	Sundays and Holidays*	Monday to Saturday	Sundays and Holidays*
1:00:00 AM (001-0100)	3.6039	3.7635	3.6039	3.6039
2:00:00 AM (0101-0200)	3.6039	3.6039	3.6039	3.6039
3:00:00 AM (0201-0300)	3.6039	3.6039	3.6039	3.6039
4:00:00 AM (0301-0400)	3.6039	3.6039	3.6039	3.1262
5:00:00 AM (0401-0500)	3.6039	3.6039	3.6039	3.1262
6:00:00 AM (0501-0600)	3.6039	3.6039	3.6039	3.1262
7:00:00 AM (0601-0700)	3.6039	3.6039	3.6039	3.1262
8:00:00 AM (0701-0800)	3.8869	3.6039	3.7635	3.6039
9:00:00 AM (0801-0900)	7.0403	3.6039	3.8869	3.6039
10:00:00 AM (0901-1000)	7.7896	3.7635	7.2485	3.7635
11:00:00 AM (1001-1100)	7.7896	3.7635	7.7896	3.7635
12:00:00 PM (1101-1200)	7.7896	3.7635	7.2485	3.7635
1:00:00 PM (1201-1300)	7.7896	3.7635	7.2485	3.7635
2:00:00 PM (1301-1400)	7.7896	3.7635	7.7896	3.7635
3:00:00 PM (1401-1500)	7.7896	3.7635	7.2485	3.7635
4:00:00 PM (1501-1600)	7.7896	3.7635	7.0403	3.7635
5:00:00 PM (1601-1700)	7.2485	3.7635	6.8094	3.7635
6:00:00 PM (1701-1800)	7.2485	3.7635	7.2485	3.8869
7:00:00 PM (1801-1900)	7.7896	7.0403	7.7896	6.8094
8:00:00 PM (1901-2000)	7.7896	7.0403	7.2485	6.8094
9:00:00 PM (2001-2100)	7.2485	4.5207	7.0403	3.8869
10:00:00 PM (2101-2200)	4.5207	3.8869	3.8869	3.7635
11:00:00 PM (2201-2300)	3.8869	3.7635	3.7635	3.6039
12:00:00 AM (2301-0000)	3.7635	3.6039	3.6039	3.6039

13. Similar to the 1st ESC, the BER in TOU with an indicative average PhP5.6261/kWh of the 2nd ESC shall remain constant over the entire duration of the contract regardless of any adjustments in the NPC TOU Rates by virtue of future approvals by the Commission giving INEC and its member-consumers a firm and competitive BER;
14. Likewise, the 2nd ESC provides for a cost adjustment mechanism or the Basic Energy Rate Adjustment Formula (BERAF) that shall determine a reasonable level of adjustment to be implemented prospectively by SMEC on a monthly basis to reflect approximate movements in its cost of generation in consideration of the effects of changes in

fuel prices, particularly, coal, Philippine Peso to US Dollar exchange rate fluctuations and effects of inflation based on Consumer Price Indices (CPIs) of both the Philippines and the US, as changes in these factors are beyond its control. Base Prices under this ESC are updated to October 2011 levels and shall remain constant throughout the duration of the contract;

15. The Basic Energy Rate Adjustment Factor (BERAF) formula which is attached as Annex IV of the 2nd ESC is as follows:

$$\text{BERAF} = A \times \left\{ \frac{\text{FCI}_c}{\text{FCI}_b} \right\} \times \left\{ \frac{\text{FX}_c}{\text{FX}_b} \right\} + B \left\{ \frac{\text{USCPI}_c}{\text{USCPI}_b} \right\} \times \left\{ \frac{\text{FX}_c}{\text{FX}_b} \right\} C \times \left\{ \frac{\text{PhilCPI}_c}{\text{PhilCPI}_b} \right\}$$

Where:

- BERAF** = Basic Energy Rate Adjustment Factor that shall be applied to the weighted average BER-TOU. Factor can be either >100% or <100% depending on the movement of the current indices or equal to 100% should the current indices are equal to the base indices
- FCI_c** = Current Fuel Cost Index stated in US\$/MT based on Global Coal Newcastle posting covering the current calendar month
- FCI_b** = Base Fuel Cost Index stated in US\$/MT based on Global Coal Newcastle posting for October 2011
- FX_c** = Average of the exchange rate of the Philippine Peso to the US Dollar as published by the Bangko Sentral ng Pilipinas (BSP) for the current billing month
- FX_b** = Average of the exchange rate of the Philippine Peso to the US Dollar as published by the BSP for October 2011
- USCPI_c** = United States (US) Consumer Price Index (CPI) for All Urban Consumers – All Items (1982-84 = 100) for the current calendar month
- USCPI_b** = US CPI for All Urban Consumers – All Items (1982-84 = 100) for October 2011
- PhilCPI_c** = CPI for All Income Households in the Philippines – All Items (2000 = 100) for the current calendar month
- PhilCPI_b** = CPI for All Income Households in the Philippines – All Items (2000 = 100) for the October 2011

Base Indices		October 2011 (For December 26, 2011 to December 25, 2016)
FCI _b	Fuel Cost Index, US\$/MT	119.4800
FX _b	Average Exchange Rate, PHP/US\$	43.4014
USCPI _b	US Consumer Price Index, Fixed Value	226.4210
PhilCPI _b	Philippine Consumer Price Index, Fixed Value	127.3000

Coefficients:

- A** = 47.5% = Fuel Cost
- B** = 15.2% = Monthly payments to PSALM
- C** = 37.3% = Others – Local

16. Under the 2nd ESC, INEC may avail of a Prompt Payment Discount (PPD) equivalent to three percent (3%) of the power bill including value-added tax (VAT), provided that the same power bill is paid in full within ten (10) days upon receipt of the power bill but not to extend beyond the 10th day of the month following the billing month, provided further, that it has no outstanding obligation arising from previous power bills. This three percent (3%) PPD privilege shall be available to it whether or not if NPC, under its current rate structure, decides to discontinue the granting of the three percent (3%) PPD to its remaining customers;
17. SMEC shall grant INEC an efficiency discount applicable to its entire electricity consumption, subject to compliance of the required collection efficiency levels to be supported with financial statements submitted to the National Electrification Administration (NEA), provided further, that it has no outstanding obligation arising from its previous power bills. The table below (also attached as Annex V of the 2nd ESC) contains its required collection efficiency levels from its member-consumers and the levels of discount in (PhP/kWh) that may be granted by SMEC:

Collection Efficiency Level	Discount (PhP/kWh)
Below 75%	None
75%-80%	(0.1000)
81%-85%	(0.1500)
86%-90%	(0.2000)
91%-95%	(0.2500)
96% and above	(0.3000)

Rate Impact

18. The rate impact of the 2nd ESC vis-a-vis NPC rates are as follows:

Test Period: December 26, 2011 to
January 25, 2012 Billing Period

Effective Generation Rate, PhP/kWh				
NPC/ PSALM (PhP/kWh)	SMEC's 1 st ESC (PhP/kWh)	SMEC's 2 nd ESC (PhP/kWh)	Increase/(Decrease) SMEC's 1 st ESC vs. SMEC's 2 nd ESC (PhP/kWh)	Increase/(Decrease) NPC/PSALM vs. SMEC's 2 nd ESC (PhP/kWh)
5.7735	4.9544	5.5296	0.5752	(0.2439)

19. As can be gleaned from the foregoing, the overall rate impact is a decreased rate of PhPo.0073/kwh using April 2011 data;
20. As can be gleaned from the foregoing, the overall rate impact between the 1st and 2nd ESCs is an increase of PhPo.5752/kWh using INEC's actual load profile and prevailing financial indices for the billing period December 26, 2011 to January 25, 2012. This rate difference would reasonably cover SMEC's increase in production cost over

the entire duration of the contract or from calendar years 2012 to 2016 vis-a-vis the period covered by the 1st ESC which is from calendar years 2010 to 2011 only. Nevertheless, SMEC 2nd ESC rate is clearly cheaper by PhPo.2439/kWh than the current NPC rate;

21. In compliance with Rule 20B of the ERC Rules of Practice and Procedure, copies of the foregoing are attached as annexes to the application:

21.1 2nd ESC between INEC and SMEC;

21.2 Letter of Agreement;

21.3 Articles of Incorporation of SMEC;

21.4 Certificate of Registration of SMEC issued by the Securities and Exchange Commission (SEC);

21.5 Latest General Information Sheet (GIS) of SMEC;

21.6 SMEC's Application for Registration with the Board of Investment (BOI);

21.7 Environmental Compliance Certificate (ECC) issued by the Department of Environment and Natural Resources (DENR) to the Sual Coal- Fired Power Project of the Pangasinan Electric Corporation;

21.8 CSEE between INEC and NPC;

21.9 Details of the 2nd ESC (Executive Summary);

21.10 INEC's Sources of Funds;

21.11 Purchased power rates computations thereof; and sample

21.12 SMEC's cash flow indicating initial costs and operating and maintenance (O & M) expenses;

21.13 Details of procurement process of fuel;

21.14 Transmission Service Agreement (TSA) between INEC and the National Grid Corporation of the Philippines (NGCP);

21.15 Certificate of Compliance (COC) issued by the Commission;

21.16 Certification issued by the Local Government Unit Legislative Body of the Municipality of Dingras and the Province of Ilocos Norte;

- 21.17 Newspaper where the application was published; and
- 21.18 Affidavit of Publication;
- 22. Further, in compliance with Article VI, Section 1 and 2 of the Commission's *Guidelines for the Recovery of Costs for the Generation Component of the Distribution Utilities' (OU) Rates*, copies of the foregoing are, likewise, attached as annexes to the application:
 - 22.1 NPC certification stating that its rights and obligations under its CSEE with INEC has been assigned to SMEC;
 - 22.2 Relevant technical and economic characteristics of the generation capacity of SMEC;
 - 22.3 SMEC's cost analysis related to generation support of the proposed pricing provision of the 2nd ESC,
 - 22.4 Publication of Invitation to Bid, Letters of Intent and Proposal of SMEC to INEC;
 - 22.5 Recommendation from the BAC for award of the contract to SMEC;
 - 22.6 Notice of Award to SMEC;
 - 22.7 INEC's Board Resolution approving the 2nd ESC with SMEC;
 - 22.8 INEC's Board Resolution approving the filing of the application with the Commission;
 - 22.9 SMEC Board Resolution approving the 2nd ESC with INEC;
 - 22.10 Details regarding the transmission projects or grid connection projects;
 - 22.11 Statement of Consistencies between the existing generation capacity and the Department of Energy's (DOE) Philippine Power Development Plan (PDP);
 - 22.12 INEC load forecast projections for calendar year 2010;
 - 22.13 INEC's Demand Side Management (DSM) Program;
 - 22.14 INEC's latest audited financial statement (AFS), balance sheet and cash flow; and
 - 22.15 SMEC's latest AFS, balance sheet and cash flow;

**Allegations in Support for the Prayer for
Provisional Authority**

23. They replead the above-mentioned allegations in support of their prayer for the immediate issuance of a provisional authority;
24. The Commission's approved CSEE between INEC and NPC has expired;
25. The application is being filed in line with the first (1st) and fifth (5th) "WHEREAS Clauses" of the Department of Energy (DOE) Circular No. 2003-12-11, to wit:
- "WHEREAS, Section 2 of Republic Act No. 9136, also known as the Electric Power Industry Reform Act of 2001 or EPIRA, declared as a policy of the State, among others, [t]o ensure the quality, reliability, security and affordability of the supply of electric power;" (1st "WHEREAS Clause", DOE Circular No. 2003-12-11). (*Underscoring supplied*)
- "WHEREAS, pursuant to Section 23 of EPIRA, all distribution utilities, as defined in the law, shall have the obligation to supply electricity in the least cost manner to its captive market subject to the collection of retail rate duly approved by the Energy Regulatory Commission" (5th "WHEREAS Clause", *ibid*). (*Underscoring supplied*)
26. Moreover, Section 1 of the same Department Circular declares as State policy, that:
- "All distribution utilities must henceforth take cognizance and assume full responsibility to forecast, assure and contract for the supply of electric power in the respective franchise areas to meet their obligations as a distribution utility." (*Underscoring supplied*)
27. By way of emphasis, Resolution No. 21, Series of 2005 of the Commission dated October 19, 2005 had directed all DUs "to enter into future bilateral power supply contract with power producers to be subjected to a review by the Commission" (*Underscoring supplied*)
28. In the interest of the public, there is a necessity for the immediate and provisional approval of the application in order that there will be no undue disruption in the power supply and the member-consumers of INEC shall, at the soonest possible time, benefit from the lower generation cost as can be gleaned from the proposal of SMEC;

29. Notwithstanding the suspension of the amendment to the ERC Guidelines on the Recovery of Costs for the Generation Component of the Distribution Utilities' (DUs) Rates in 2004 by virtue of ERC Resolution No. 21, Series of 2006 dated May 10, 2006 which has not been lifted up to the present, INEC still conducted a selection process that resulted to the awarding of the supply contract to SMEC containing competitive pricing structure and other favorable provisions that would benefit it and its member-consumers;
30. Moreover, ERC Resolution No. 16, Series of 2008 dated December 15, 2008, more particularly, Sections 2 and 5 thereof allow the parties to a Transition Supply Contract (TSC) prior to the expiration of the TSC which has been assigned and transferred, to negotiate for and enter into a new bilateral power supply contract that should govern the transactions between the parties. That was what they did in the case, prior to the expiration of the 1st ESC;

Request for Confidential Treatment

31. Invoking the provisions of Rule 4 of the ERC Rules of Practice and Procedure, SMEC prays for the confidential treatment of the information contained in the following documents:
 - 31.1. Cash flow indicating initial costs and O & M expenses; and
 - 31.2. Cost analysis related to the generation in support of the proposed pricing provisions of the 2nd ESC.
32. It has valuable proprietary interest in securing the confidentiality of the foregoing information particularly from existing and potential competitors in the power generation sector. Public exposure of these sensitive information/data, particularly the full details thereof, could give these parties a competitive advantage over SMEC as they would have the opportunity and ability to utilize the ingenuity involved in the computations in arriving at the data/information sought to be protected; and

Prayer

33. They pray, that:
 - 33.1. Upon initial review of the application and pending trial on the merits, the Commission issue an Order granting provisional authority for them to implement the 2nd ESC and its amendments; and
 - 33.2. After trial on the merits, the Commission issue a Decision permanently approving the 2nd ESC and its amendments, subject of the application.

Having found said application sufficient in form and in substance with the required fees having been paid, an Order and a Notice of Public Hearing, both dated July 5, 2012, were issued setting the case for jurisdictional hearing, expository presentation, pre-trial conference and evidentiary hearing on July 25, 2012.

INEC and SMEC were directed to cause the publication of the Notice of Public Hearing, at their own expense, twice (2x) for two (2) successive weeks in two (2) newspapers of general circulation in the Philippines, with the date of the last publication to be made not later than ten (10) days before the scheduled date of initial hearing. They were also directed to inform INEC's member-consumers, by any other means available and appropriate, of the filing of the application, their reasons therefor, and of the scheduled hearing thereon.

The Office of the Solicitor-General (OSG), the Commission on Audit (COA) and the Committees on Energy of both Houses of Congress were furnished with copies of the Order and Notice of Public Hearing and were requested to have their respective duly authorized representatives present at the initial hearing.

Likewise, the Offices of the Mayors of the Cities and Municipalities within INEC's franchise area and the Provincial Governor of Ilocos Norte were furnished with copies of the Order and Notice of Public Hearing for the appropriate posting thereof on their respective bulletin boards.

On July 23, 2012, INEC and SMEC submitted their "Joint Pre-Trial Brief".

During the July 25, 2012 initial hearing, only INEC and SMEC appeared. No intervenor/oppositor appeared nor was there any intervention/opposition registered.

At the said hearing, INEC and SMEC presented their proofs of compliance with the Commission's posting and publication of notice requirements which were duly marked as Exhibits "KK" to "NN-1", inclusive.

Thereafter, INEC and SMEC made an expository presentation of their application. At the termination of the expository presentation, the Commission conducted a pre-trial conference.

Subsequently, INEC and SMEC presented the following witnesses: a) Mr. Alberto B. Reyes III, SMEC's Tariff Rates Associate, who testified, among others, on the capacity and ability of SMEC to comply with the ESC, and the reasonableness of the Electricity Fees stipulated in the said ESC; and b) Mr. Renato A. Balintec, INEC's General Manager, who testified, among others, to prove the due execution and terms and conditions of the ESC, the power supply requirements of INEC, the due diligence in securing the said power requirements at reasonable costs to its member-consumers, and the resulting generation rate in the event the ESC is approved by the Commission.

In the course of their respective direct examinations, the witnesses identified various documents which were duly marked as exhibits.

The said witnesses were, likewise, required to address the clarificatory questions propounded by the Commission. INEC and SMEC were directed to submit various documents to facilitate the evaluation of the application.

On August 6, 2012, INEC and SMEC filed "Formal Offer of Documentary Exhibits".

On August 10, 2012, INEC and SMEC filed their "Compliance".

On August 22, 2012, the Commission issued an Order provisionally approving the application, the dispositive portion of which reads as follows:

"WHEREFORE, the foregoing premises considered, the Commission hereby PROVISIONALLY APPROVES the second (2nd) Energy Supply Contract (ESC) between Iocos Norte Electric Cooperative, Incorporated (INEC) and San Miguel Energy Corporation (SMEC), subject to the following conditions:

- a. The Hourly Basic Energy Rate (exclusive of Basic Energy Rate Adjustment Factor formula) shall be as follows:*

Period	(January to June)		(July to December)	
	Monday to Saturday	Sunday and Holiday	Monday to Saturday	Sunday and Holiday
1:00:00 AM (0000-0100)	2.1426	2.3022	2.1426	2.1426
2:00:00 AM (0100-0200)	2.1426	2.1426	2.1426	2.1426
3:00:00 AM (0200-0300)	2.1426	2.1426	2.1426	2.1426
4:00:00 AM (0300-0400)	2.1426	2.1426	2.1426	1.6649
5:00:00 AM (0400-0500)	2.1426	2.1426	2.1426	1.6649
6:00:00 AM (0500-0600)	2.1426	2.1426	2.1426	1.6649
7:00:00 AM (0600-0700)	2.1426	2.1426	2.1426	1.6649
8:00:00 AM (0700-0800)	2.4256	2.1426	2.3022	2.1426
9:00:00 AM (0800-0900)	5.5790	2.1426	2.4256	2.1426
10:00:00 AM (0900-1000)	6.3283	2.3022	5.7872	2.3022
11:00:00 AM (1000-1100)	6.3283	2.3022	6.3283	2.3022
12:00:00 PM (1100-1200)	6.3283	2.3022	5.7872	2.3022
1:00:00 PM (1200-1300)	6.3283	2.3022	5.7872	2.3022
2:00:00 PM (1300-1400)	6.3283	2.3022	6.3283	2.3022
3:00:00 PM (1400-1500)	6.3283	2.3022	5.7872	2.3022
4:00:00 PM (1500-1600)	6.3283	2.3022	5.5790	2.3022
5:00:00 PM (1600-1700)	5.7872	2.3022	5.3481	2.3022
6:00:00 PM (1700-1800)	5.7872	2.3022	5.7872	2.4256
7:00:00 PM (1800-1900)	6.3283	5.5790	6.3283	5.3481
8:00:00 PM (1900-2000)	6.3283	5.5790	5.7872	5.3481
9:00:00 PM (2000-2100)	5.7872	3.0594	5.5790	2.4256
10:00:00 PM (2100-2200)	3.0594	2.4256	2.4256	2.3022
11:00:00 PM (2200-2300)	2.4256	2.3022	2.3022	2.1426
12:00:00 AM (2300-2400)	2.3022	2.1426	2.1426	2.1426

b. *In the event that the rates provisionally approved are found to be higher than the final rates, the amount corresponding to the excess shall be refunded by INEC to its member-consumers by crediting the same in their electric bills over a period to be determined by the Commission.*

*INEC is hereby directed to **PASS ON** to its member-consumers fifty percent (50%) of the Prompt Payment Discount (PPD) availed from SMEC and fifty percent (50%) of the Collection Efficiency Discount granted to it."*

On December 5, 2012, INEC and SMEC filed their "Supplemental Formal Offer of Evidence".

On August 12, 2013, the Commission issued an Order extending the provisional authority granted to INEC and SMEC in the Order dated August 22, 2012 until revoked or made permanent since it was still in the process of evaluating the application.

On November 25, 2013, the Commission issued an Order admitting INEC and SMEC's formal offer of documentary exhibits and supplemental formal offer of evidence for being relevant and material in the evaluation of the application.

On 17 August 2015, the Commission deliberated and decided the instant Application. However, due to supervening events¹, the Decision could no longer be promulgated without undergoing reconfirmation by the Commission *En Banc*. Thus, the Commission resolved to reconfirm the Decision on 15 June 2017.

DISCUSSION

1. SMEC's Proposed Rates

The proposed rates of SMEC with various distribution utilities (DUs) were structured as Time-of-Use (TOU) Rates at the following Basic Energy Rates (BER):

SMEC Basic Energy Rate, PhP/kWh						
Year 2010 to 2011, PhP/kWh			Year 2012 Onwards, PhP/kWh			
4.1648	4.2648	4.3248	4.5448	5.0522	5.2522	5.4656
			5.5317	5.6261	5.9287	5.9739

SMEC opted to maintain the design of the National Power Corporation (NPC) TOU rates by simply deducting or adding, as the case may be, the difference between its BER and NPC Average Generation Rate on top of each hourly rate interval. Thus, similar with the NPC TOU design, SMEC was able to establish four (4) sets of hourly TOU rate schedules with similar Dry and Wet as well as Weekday and Weekend rates.

SMEC averred that the PhP4.1648/kWh initial rate it offered to distribution utilities during the period December 2009 to January 2010, is based on projected operating cost considering that it is relatively new to the industry and its operating cost is not yet fully established. The PhP4.1648/kWh initial rate, which is lower than NPC's then prevailing Basic Generation Charge by PhP0.20/kWh, was offered to attract potential buyers.

For its subsequent offers to other DUs, SMEC, in calculating its proposed average BERs of PhP4.2648/kWh, PhP4.3248/kWh and PhP4.5448/kWh - PhP5.9739/kWh for calendar years 2010, 2011 and 2012 onwards, respectively, considered the following assumptions and major cost components:

¹ The Chairman was placed on preventive suspension as per Order of the Office of the President (OP-DC Case No. 17-D-094) dated 2 May 2017 and received on 04 May 2017.

- a. Average fuel and other variable costs at December 2009 base prices;
- b. Estimated total annual operating, fixed, general and administrative costs; and
- c. Reasonable margin that would allow it to operate viably and supply reliable electricity to its customers.

Coefficients for Years, 2010, 2011, 2012, 2013, and Onwards

Coefficients	Years 2010 and 2011					
	(PhP/kWh)	%	(PhP/kWh)	%	(PhP/kWh)	%
A	2.0770	50.00	2.0770	48.70	2.0770	48.00
B	0.6066	15.00	0.5678	13.30	0.5257	12.20
C	1.4812	35.00	1.6201	38.00	1.7221	39.80
Total	4.1648	100.00	4.2648	100.00	4.3248	100.00

Coefficients	Years 2012, 2013, and Onwards							
	(PhP/kWh)	%	(PhP/kWh)	%	(PhP/kWh)	%	(PhP/kWh)	%
A	2.0770	45.70	2.8439	56.29	2.5456	48.50	2.5717	47.10
B	0.5257	11.60	0.4815	9.53	0.6872	13.10	0.7661	14.00
C	1.9421	42.70	1.7268	34.18	2.0194	38.40	2.1278	38.90
Total	4.5448	100.00	5.0522	100.00	5.2522	100.00	5.4656	100.00

A	2.5175	45.5	2.6723	47.50	2.5425	42.90	2.5467	42.60
B	0.8150	14.7	0.8582	15.20	0.9715	16.40	0.9890	16.60
C	2.1992	39.8	2.0956	37.30	2.4147	40.70	2.4382	40.80
Total	5.5317	100.00	5.6261	100.00	5.9287	100.00	5.9739	100.00

Where:

- A = Fuel, Energy Fees and other variable operating costs
- B = Fifty percent (50%) (Foreign) Component of Amortization of IPPA Fees
- C = All Other Revenue Requirement including fifty percent (50%) (Local) Component of Amortization of IPPA Fees

SMEC submitted that its proposed annual average of PhP4.2648/kWh is lower than NPC's then prevailing Basic Generation Charge (PhP4.3648/kWh annual average) by PhP0.10/kWh. However, the PhP4.3248/kWh proposed BER for calendar year 2011 and PhP4.5448/kWh proposed BER for calendar year 2012 is PhP0.04/kWh lower and PhP0.18/kWh higher, respectively, than the then prevailing NPC Average TOU rate of PhP4.3648/kWh, as shown below:

Year	SMEC's BER (PhP/kWh)	NPC's Average TOU (PhP/kWh)	Difference (PhP/kWh)
2010	4.2648	4.3648	(0.1000)
2011	4.3248	4.3648	(0.0400)
2012	4.5448	4.3648	0.1800

SMEC further manifested that the PhPo.10/kWh and PhPo.04/kWh negative differences as well as the PhPo.18/kWh positive difference is neither a discount from nor a premium on top of the existing NPC TOU Rates since the average BERs of PhP4.3248/kWh for the contract period June 26, 2011 to December 25, 2011 and PhP4.5448/kWh for the contract period December 26, 2011 to December 25, 2012 were derived from its calculation of the estimated generation costs to supply a contracted customer.

Moreover, it averred that its calculations do not specifically identify the variance with any specific cost over and above the prevailing average NPC TOU Rates as the latter was computed based on NPC's financial costs for calendar year 2007, as provisionally approved by the Commission in its Order dated February 16, 2009 in ERC Case No. 2009-004 RC²

2. Evaluation of the Proposed Rates

To ensure that the base electricity fees would allow only for the recovery of prudent and reasonable costs incurred, the Commission made an evaluation of SMEC's true cost of generation by referring to the historical cost of operations as reflected in its 2010 to 2012 Audited Financial Statements (AFS). The figures reflected in the AFS represent the actual costs incurred which was objectively verified and validated by an Independent Third Party.

Using the audited data and other available information, the Commission made an evaluation to determine the reasonableness of SMEC's proposed rates and approximate the same to its true cost of generation. Thus, in computing for the recoverable generation rate, the Commission considered the following rate components:

- a. Capital Recovery Fee (CRF)** - refers to the recovery of SMEC's invested capital as an IPPA plus a reasonable return;
- b. Operations and Maintenance (O&M) Fee** - refers to recovery of the general and administrative expenses incurred by SMEC in the performance of its functions as the IPPA of its contracted capacity;

² In the Matter of the Application for the Approval of the Proposed New Basic Generation Rates for Luzon, Visayas and Mindanao Grids with Prayer for Provisional Authority, NPC and PSALM – Applicants.

- c. Energy Fee** - refers to recovery of the monthly energy fees paid by SMEC to PSALM (equivalent to the amount paid by NPC/PSALM to the IPP). The energy fees, similar to the Monthly Capacity Fees, have a Peso and Dollar denominated base fees; and
- d. Fuel Cost** - refers to recovery of the cost of fuel used by the IPP to generate the contracted capacity. Under the IPPA Agreement, the Administrator has the obligation to supply and deliver the fuel requirement of an IPP for the contracted capacity in accordance with the specifications of the original Energy Conversion Agreement (ECA). It is a pass-through cost, subject to guaranteed heat rates under the said IPPA Agreement.

2.1 Capital Recovery Fee

In computing the applicable CRF, the Commission determined the capital cost for recovery, the return on working capital and the saleable generation (Billing Determinant) of the Sual Power Plant.

The Commission used the net amount of Property, Plant and Equipment (PPE) reflected in SMEC's 2012 AFS as the appropriate asset base.

In accounting for its IPPA Agreement, SMEC considered the same as an agreement that contains a lease since it has substantially acquired all the risks and rewards incidental to the ownership of a power plant. Accordingly, it accounted the said agreement as a finance lease and recognized the power plant in its books as non-current asset under PPE.

The power plant was valued equal to the present value of SMEC's future payments to PSALM using the Philippine peso and US dollar discount rates.

The use of net amount of PPE is similar with the methodology typically adopted by the Commission relative to IPPs where capital investment for construction of power plant is incurred at the beginning or to those that pay for the plant acquisition cost upfront.

The CRF was computed using an asset base equivalent to the net amount of PPE as reflected in SMEC's 2012 AFS and a return equal to the previously approved Weighted Average Cost of Capital

(WACC) of 13.59%, as approved by the Commission in its Decision dated July 30, 2012 in ERC Case No. 2011-138 RC³.

In computing the billing determinant, the Commission used the actual kWh sales of SMEC.

2.2 Operations and Maintenance Fee

For the O&M Fee computation, the Commission made reference to SMEC's actual cost of operations, as disclosed in its 2010, 2011 and 2012 AFS.

The Commission disallowed the Provision for Impairment Losses of Receivables since it is a non-recurring expense. Likewise, the Commission disallowed the cost corresponding to Donations (or charitable contributions) since these are typically classified as non-generation expense which are generally for the account of the company and not intended for recovery from the customers, The Commission also excluded the Depreciation Expense for Furniture and Fixtures and Equipment since the same were already included in the net amount of PPE used in the computation of the CRF.

2.3 Energy Fee

The Energy Fees were verified to be pass-through costs representing the monthly charges that an IPPA is required to pay PSALM under their IPPA Agreement. This is a "back-to-back" payment as defined in the ECA and which are charged, and payable to the IPP. The obligation of NPC/PSALM to pay Energy Fee to the IPP was basically transferred to its appointed IPP Administrator, in this case, to SMEC.

This cost component is for the recovery of the monthly energy fees that SMEC pays to PSALM for the actual energy delivered by the IPP (equivalent to the amount paid by NPC/PSALM to the IPP). The Energy Fee is similar to the Monthly Capacity Fee, which has both Peso and Dollar denominated base fees and are adjusted using the Philippine and US CPIs, respectively.

³ In the Matter of the Application for Approval of the Power Sales Agreement, as Amended, Among South Cotabato II Electric Cooperative, Inc. (SOCOTECO II), Conal Holdings Corporation (CHC) and Sarangani Energy Corporation (SEC), SOCOTECO II and SEC - Applicants

In computing for the base Energy Fee, the Commission referred the same to the actual Energy Fees paid by SMEC to PSALM in years 2010, 2011, and 2012, as reported in its AFS for the said years.

The Commission computed the applicable Energy Fees based on the average actual energy cost from 2010 to 2012 and the average actual kWh generated by the Sual Power Plant in relation to the 1,000 MW contracted capacity during the relevant periods.

2.4 Fuel Fee

In the same IPPA Agreement, SMEC has the obligation to supply and deliver, at its own cost, all fuel requirements of the power plant in accordance with the specifications provided in the ECA.

In computing the base Fuel Fee, the Commission made reference to the actual Fuel Cost incurred by SMEC for the years 2010, 2011 and 2012, as reported in its AFS for the said years.

Similar with its derivation of the Energy Fees, the Commission computed the applicable Fuel Fee based on the average actual fuel cost from 2010 to 2012 and the average actual kWh generated by the Sual Power Plant in relation to the 1,000 MW contracted capacity during the relevant periods.

2.5 Rate Derivation

Based on the foregoing discussions, the Commission initially derived a levelized generation rate applicable for SMEC.

Subsequently, the Commission made a comparison between and among its computed levelized generation rate and SMEC's proposed rates with various DUs.

The proposed rates of SMEC with said various DUs were designed to be competitive with the then prevailing prices in the market and to ensure that it will be able to pay the expected costs, specifically, its fixed monthly payment to PSALM as embodied in their IPPA Agreement. The said fixed monthly payments to PSALM are increasing throughout the term of the IPPA Agreement, or from January 2010 until October 2024.

This is the main reason why the proposed rates vary depending on the cost assumptions of SMEC during the period of negotiation with its customers.

On the other hand, the Commission's computed generation rate is not reflective of SMEC's increasing monthly payments to PSALM. Instead, the rate was computed based on SMEC's levelized annual revenue requirement.

For purposes of determining the reasonableness of SMEC's proposed rates vis-à-vis the computed generation rate under the cost-based methodology, the Commission determined the former's weighted average rate based on the proposed rates under its ESCs and the expected electricity sales to its customers.

Moreover, the Commission considered the effects and benefits of implementing such rates to the end-consumers and the effects thereof on the financial viability of SMEC in providing reliable supply to its customers.

Based on its simulation, the Commission found that the weighted average of SMEC's proposed rates under its ESCs is reasonable as the same is within the level of the computed generation rate for SMEC. Thus, the Commission approves the proposed rates under the subject 2nd ESC as the same will redound to the benefit of INEC's member-consumers.

3. Evaluation of the Non-Rate Provisions of the 2nd ESC

A thorough evaluation of the 2nd ESC entered into by and between INEC and SMEC disclosed that the non-rate provisions thereof are reasonable and in accordance with accepted industry practice, except the following provisions:

"2nd paragraph of Section 3.1 (Contract Duration and Effectivity)

In the event that ERC issues an order, provisional or otherwise, disapproving any of the terms of the Contract that will effectively amend the agreement of the Parties, the Parties shall endeavor to renegotiate the Contract no later than sixty (60) days from effective date of such ERC approval/amendment. In the event that no such agreement is reached by the Parties within this period of sixty (60) days, the original terms of this Contract shall prevail. For the

avoidance of doubt, until the Parties have mutually agreed on the amendment of the terms of this Contract, the terms and conditions as originally specified herein shall Prevail."

The Commission believes that this Decision should bind both contracting parties and that their 2nd ESC shall not be rendered ineffective or nugatory by any termination or "walk-away" clause in the 2nd ESC by reason of this Decision. Thus, the Commission deems it prudent to disallow the foregoing provisions.

As regards the provision wherein a customer is not a direct WESM member, the 2nd ESC provides that:

"Section 4.3.a Customer is not a Direct WESM Member.

Whenever available, in accordance with good utility practice, the SUPPLIER may, but shall not be obliged to provide electricity to the CUSTOMER in excess of Contract Energy, provided that for consumption in excess of one hundred twenty percent (120%) of the Contract Energy level, the basic energy charge to be applied shall be the Basic Energy Rate including but not limited to other adjustments or the WESM rate, whichever is higher, plus ten percent (10%) of such rate."

The Commission finds the foregoing to be unreasonable. In this regard, the Commission deems it necessary to modify the same so that: *"In the event that the SUPPLIER provided electricity in excess of one hundred twenty percent (120%) of the contracted energy to the CUSTOMER, the basic energy rate shall be the actual cost incurred by the SUPPLIER in providing such additional energy. For electricity purchased beyond the contracted energy but within one hundred twenty percent (120%) thereof, the rate shall be the approved basic energy rate"*.

The Commission has a mandate to protect the interest of the electricity consumers insofar as they are affected by the rates, by ensuring that the tariffs imposed are consistent with the principle of full recovery of prudent and reasonable costs.

After a thorough evaluation of the documents submitted and the testimonies of the witnesses presented, the Commission finds that the approval and implementation of the 2nd ESC will be beneficial to

INEC's member-consumers by way of reliable, continuous and efficient supply of power within its franchise area at reasonable costs as mandated by the Electric Power Industry Reform Act of 2001 or the EPIRA [Section 2. Declaration of Policy - (b) "to ensure the quality, reliability, security and affordability of the supply of electric power].

WHEREFORE, the foregoing premises considered, the provisional authority granted to Ilocos Norte Electric Cooperative, Incorporated (INEC) and San Miguel Energy Corporation (SMEC) on August 22, 2012 in relation to this application, is hereby made **PERMANENT**, subject to the following modifications:

1. The applicable base rates shall be the Time-of-Use (TOU) rates provided under the 2nd ESC, which shall be adjusted in accordance with the Adjustment Formula stated therein; and
2. SMEC's actual cost of operation and construction shall be audited by an Independent Third Party, in accordance with the rules to be promulgated by the Commission, and the approved rates herein shall be adjusted, if warranted. The test of reasonability shall be "*whether or not such cost is incurred based on a good utility practice and comparable or within the level of the power plants similarly situated to that of SMEC*" and **NOT** the actual cost incurred. The cost of audit shall be shouldered by SMEC.

The Commission further **RESOLVES** to:

1. **DISALLOW** the termination or "walk-away" clause (2nd paragraph of Section 3.1) incorporated in the 2nd ESC;
2. **MODIFY** the provision of the 2nd ESC under Section 4.3.a (Customer is not a Direct WESM Member), so that: "*In the event that the SUPPLIER provided one hundred twenty percent (120%) of the contracted energy to the CUSTOMER, the basic energy charge shall be the actual cost incurred by the SUPPLIER in providing such additional energy and not on the WESM rate or ESC rate, whichever is higher*";

3. **DIRECT** INEC and SMEC to **SUBMIT**, within thirty (30) days from receipt hereof, their proposed refund or recovery scheme, as the case may be, for the difference between the final approved rates and the provisionally implemented rates; and
4. **DIRECT** INEC to **PASS ON** to its member-consumers fifty percent (50%) of the Prompt Payment Discount (PPD) availed from SMEC and fifty percent (50%) of the Collection Efficiency Discount (CED) granted to it.

SO ORDERED.

Pasig City, 15 June 2017.

JOSE VICENTE B. SALAZAR*
Chairman and CEO


ALFREDO J. NON
Commissioner


GLORIA VICTORIA C. YAP-TARUC
Commissioner


JOSEFINA PATRICIA A. MAGPALE-ASIRIT
Commissioner


GERONIMO D. STA. ANA
Commissioner

LS: LSP/APV/ERC CASE NO. 2012-079 RC.DÉCISION

TWG-B: LOC/AJMO/FG

*The Chairman was placed on preventive suspension as per Order of the Office of the President (OP-DC Case No. 17-D-094) dated 2 May 2017 and received on 04 May 2017.

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