

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



IN THE MATTER OF THE
APPLICATION FOR THE
APPROVAL OF
APPLICANT'S (1) BUSINESS
SEPARATION AND
UNBUNDLING PLAN
(BSUP) AND (2)
ACCOUNTING AND COST
ALLOCATION MANUAL
(ACAM) IN COMPLIANCE
WITH REPUBLIC ACT NO.
9136 AND ITS
IMPLEMENTING RULES
AND REGULATIONS

ERC CASE NO. 2017-009MC

KEPCO SPC POWER
CORPORATION (KSPC),

Applicant.

X ----- X

DOCKETED
Date: JUL 06 2018
By: _____

DECISION

Before this Commission for resolution is the *Application* dated 29 May 2017 filed by Applicant KEPCO SPC Power Corporation (KSPC) on 16 June 2017 for approval of its Business Separation and Unbundling Plan (BSUP) and Accounting and Cost Allocation Manual (ACAM).

KSPC alleged the following in its *Application*:

1. KSPC is a generation company duly authorized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office

address at the 7th Floor of the Cebu Holdings Center, Cebu Business Park, Cebu City.

2. KSPC is a holder of Retail Electricity Supplier License No. RES – 10-2016-008, approved on October 18, 2016.
3. In compliance with the provisions of Section 36 of R.A. 9136, and Rule 10, Section 3 (b) of its implementing Rules and Regulations (IRR), which requires electric power industry participants to structurally and functionally unbundle the business activities as between generation, transmission, distribution and supply, and in compliance to the terms and conditions of the Retail Electricity Supplier's License issued by this Honorable Commission to Applicant KSPC, it herein submits this Business Separation and Unbundling Plan (BSUP) and the Accounting and Cost Allocation Manual (ACAM), for the approval of this Honorable Commission.
4. KSPC proposed BSUP consists of six (6) sections as prescribed in the BSUP Filing Package, as follows:

SECTION I. CURRENT STRUCTURE

KSPC was registered with the Securities and Exchange Commission (SEC) on June 22, 2005. The Company was incorporated to address the increasing electricity demand and imminent power shortage in 2010. To address this, KEPCO Philippines Holdings, Inc. (KPHI) took on the construction of the 200 MW Circulation Fluidized Bed Combustion (CFBC) Power Plant in the City of Naga, Cebu. The project was implemented by KSPC, a joint venture of KEPCO Philippines and SPC Power Corporation.

KSPC is responsible for the whole construction, operation, and maintenance of the plant, including fuel supply, among others, without any Philippine government guarantees.

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The Company's registered office address is located at 7th Floor, Cebu Holdings Center, Cebu Business Park, Cebu City.

SECTION II. DETAILS OF BUSINESS SEGMENTS

The Company has two (2) business segments which include:

1. Generation of Electricity and Provision of Ancillary Services; and,
2. Supply Services.

Generation of Electricity and Provision of Ancillary Services (Generation)

This segment pertains to the production of electricity and the provision of ancillary services using the generation assets. Ancillary services are essential to facilitate orderly trading in electricity and ensure that electricity supplies are of an acceptable quality.

Supply Services (Supply)

This comprises the sale of electricity by a generating company, licensed as RES, to End-users in the contestable market. It includes the following:

- a. The billing, collection and the provision of customer services to such End-users in their capacity as electricity consumers or to such other customers in their capacity as purchasers of electricity;
- b. Energy trading (including the purchase of electricity) undertaken in connection with the sale of electricity to End-users who are included in the Contestable Market; and,

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- c. The sale of electricity to End-users who are included in the Contestable Market.

SECTION III. ACCOUNTING SEPARATION

As required by Rule 10, Section 1 of the Implementing Rules and Regulations (IRR) of R.A. No. 9136 or otherwise known as the "Electric Power Industry Reform Act of 2001" (EPIRA), KSPC has prepared an Accounting and Cost Allocation Manual (ACAM) to be adopted in the preparation of the Accounting Separation Statements.

SECTION IV. DESCRIPTION OF SEPARATION

KSPC operates as a single juridical entity in the conduct of its business operations which are divided into the following business segments:

- Generation of Electricity and Provision of Ancillary Services
- Supply Services

As a policy, the Company identifies and records its business activities based on the foregoing business segments. Books of accounts are maintained to ensure that activities per business segments are separately recorded. If business activities cover multiple business segments, allocation methodologies and policies are adopted by the Company to ensure that assets, liabilities, revenues and expenses from the business activities are reasonably allocated to specific business segments.

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SECTION V. MILESTONES AND HIGHLIGHTS

KSPC commits to implement the principles and allocation methodologies as written in the ACAM. The Company will enact the following after the approval from ERC:

Week 1: Accounting system update to ensure that the cost identification and allocation methodologies as described in the ACAM are properly implemented

Week 2: Orientation to all employees involved on the BSUP

Week 3: Seminars and workshops for its employees to enhance their knowledge of the activities of each business segment

Week 4: Trainings of BSUP personnel involved in its implementation

KSPC will also continuously improve on its business processes to ensure proper monitoring or allocation of business activities per business segment.

SECTION VI. CODE OF CONDUCT

KSPC undertakes to develop a plan to comply with the Code of Conduct for Competitive Retail Market Participants as promulgated by the ERC.

PRAYER

WHEREFORE, Applicant respectfully prays that after due notice and hearing a DECISION is issued approving the Business Separation and Unbundling Plan (BSUP) and Accounting and Cost Allocation Manual (ACAM) of KSPC.

Other reliefs just and equitable are likewise prayed for.



The Commission, having found the said *Application* to be sufficient in substance with the required fees having been paid, issued an *Order* and a *Notice of Public Hearing*, both dated 26 July 2017, setting the case for determination of compliance with the jurisdictional requirements, expository presentation, Pre-trial Conference, and presentation of evidence on 05 September 2017.

In the same *Order*, KSPC was directed to cause the publication of the *Notice of Public Hearing*, at its own expense, at least once (1x) in a newspaper of general circulation in the Philippines, with the date of the last publication made not later than ten (10) days before the date of the scheduled initial hearing.

Applicant was also directed to furnish the Office of the Solicitor General (OSG), the Commission on Audit (COA), and the Committees on Energy of both Houses of Congress, whose duly authorized representatives were requested to be present at the initial hearing, with copies of the *Order* and the *Notice of Public Hearing*.

Likewise, the Offices of the City Mayor and the Local Government Unit (LGU) Legislative Body where Applicant's principal office is located were furnished with copies of the *Order* and *Notice of Public Hearing* for the appropriate posting thereof on their respective bulletin boards.

On 30 August 2017, Applicant KSPC filed its *Pre-trial Brief* dated 25 August 2017 with the attached *Judicial Affidavit* of Mr. Sang Hun Lee dated 29 August 2017.

In the 05 September 2017 hearing, only Applicant KSPC appeared. KSPC submitted its compliance with the jurisdictional requirements of the Commission which were duly marked as Exhibits "N" to "U"¹, inclusive.

The expository presentation was delivered by Ms. Rosemarie Flores, Assistant Manager for Finance of KSPC, and the printed copy of her presentation was marked as Exhibit "L".

¹ Affidavit of Publication dated 29 August 2017 issued by the Manila Standard; 24 August 2017 issue of the Manila Standard; Certification dated 22 August 2017 issued by the Office of City Administrator of the City of Cebu; Certification dated 31 August 2017 issued by the Tanggapan ng Sangguniang Panlungsod ng Lungsod ng Cebu; Letters to the following offices, transmitting copies of the Application as well as the Order and Notice of Public Hearing both dated 26 July 2017, with proof of receipt: (1) Office of the Solicitor General, (2) Commission on Audit, (3) Senate Committee on Energy, and (4) House of Representatives Committee on Energy.

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During the Pre-trial Conference, the Commission adopted the issue raised by Applicant KSPC in view of the absence of any intervenor or oppositor in the instant case.

Mr. Sang Hun Lee, KSPC's Planning and Finance Manager, was presented as Applicant's witness. He identified his Judicial Affidavit and his signature therein, which was marked as Exhibit "K".

On 08 September 2017, KSPC filed its *Compliance Supplement* of even date.

On 04 October 2017, KSPC filed its *Formal Offer of Evidence* (FOE) dated 03 October 2017.

Finding the exhibits contained in the Applicant's FOE to be relevant and material in the evaluation of the instant case, the Commission admitted the same, and submitted the instant case for resolution.

ISSUE

The issue for the Commission's resolution is whether or not the proposed BSUP and ACAM by Applicant KSPC meet the requirements of Republic Act 9136 or otherwise known as Electric Power Industry Reform Act (EPIRA) and its Implementing Rules and Regulations (IRR), and the Business Separation Guidelines (BSG) issued by the Commission.

THE COMMISSION'S RULING

After due consideration of all evidence, as well as the technical evaluation of the instant application, the Commission, on 21 June 2018, deliberated and resolved to **APPROVE KSPC'S BSUP**, subject to certain conditions and full compliance with the requirements of the BSG, as Amended.

DISCUSSION

KSPC's BSUP consists of six (6) sections as prescribed in the BSUP Filing Package provided in the Business Separation Guidelines (BSG), as follows:

1. Details of Current Structure

KSPC was registered with the Securities and Exchange Commission (SEC) on 22 June 2005. To address the increasing power demand and imminent power shortage in 2010, KSPC’s parent company, KPHI, built a 200MW Circulation Fluidized Bed Combustion (CFBC) Power Plant in the City of Naga in Cebu which KSPC implemented. As such, KSPC is responsible for the whole construction, operation and maintenance of the plant including fuel supply, among others.

KSPC operates as a single juridical entity in the conduct of its business operations and has 2 business segments: 1) Generation of Electricity and Provision of Ancillary Services; and 2) Supply Services.

2. Details of Business Segments

2.1. KSPC’s Business Segments

KSPC’s BSUP application stated that it has two (2) business segments namely (1) Generation and Ancillary Service; and (2) Supply Services or RES business. Its generation and ancillary service segment pertains to the production of electricity and the provision of ancillary services using generation assets. Its ancillary service is stated to be essential in facilitating orderly trading electricity and ensuring that electricity supplies are of an acceptable quality.

Meanwhile, its supply or RES business, refers to its sale of electricity to the contestable market which includes billing, collection and the provision of customer services to the same customers in its capacity as purchasers of electricity. Its RES business also includes energy trading in relation to the sale of electricity to contestable customers. Both KSPC’s generation and supply business segments are competitive business activities.

2.2. Manpower

In compliance with the number of individuals engaged in the activities of its business segments, KSPC detailed that it has a total of 161 personnel who will service a specific or multiple business segments, as follows:

Department	Total Number of Personnel	Number of Personnel Servicing	
		Generation	Supply
<i>Departments engaged in a specific segment:</i>			

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Operations	64	64	-
Turbine	5	5	-
Broiler and Electrical	13	13	-
Instrumentation and Control	11	11	-
Environmental and Chemical	18	18	-
Total Personnel	111	111	-

Department (Engaged in Both Business Segments)	Total Number of Personnel
Office of the President	1
Human Resources and General Affairs	15
Marketing	10
Contracts	9
Community and Public Relations	3
Planning and Finance	9
Legal	1
Audit	2
Total Personnel	50

KSPC further declared that all its personnel are properly identified to its specific business segment. However, should the employee be serving multiple business segments, the cost of such personnel shall be allocated in accordance with the allocation methodology approved by its management.

2.3 Exclusive and Shared Assets per Business Segment

Anent KSPC's exclusive and shared assets, KSPC narrated that all assets it has acquired are tagged and identified to the specific business segment it will be utilized. Such will be based on the purpose as to which the said items were procured. Assets it acquired which will be used in multiple segments are as follows:

Account	Description	Business Segments	
		Generation	Supply
Property, Plant and Equipment	This includes the building, office equipment, vehicles, furniture and fixtures, leasehold and land improvements,	x	x

	<p>machineries, heavy equipment and construction in progress which have useful lives ranging from 5-25 years.</p>		
Other noncurrent assets	<p>This account includes security deposits for leases, prepaid rent-net of current portion and others.</p>	x	x
Other current assets	<p>This includes prepaid real property tax, prepaid rent, insurance premiums paid in advance, advance payments made to suppliers and other current assets.</p>	x	x
Inventories	<p>This account pertains to coal, light oil and limestone inventories. Included also are spare parts for use in the operations of KSPC.</p>	x	N/A
Trade and other receivables	<p>This represents outstanding billings for energy fees arising from the delivery of electric power and energy from the generation and supply.</p>	x	x
Cash and cash equivalents	<p>This includes peso and dollar denominated accounts for collections and disbursements pertaining to its operations and other activities. Included also is a reserved account for dividends and subordinated principal and internal distributions.</p>	x	x

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3. Accounting Separation

The BSUP of KSPC is said to document the classification and grouping of the activities of the existing departments according to their business segment. KSPC's Accounting Separation Statements have been prepared on a historical cost basis, except for derivatives assets and liabilities which are carried at fair value. Further, the Accounting Separation Statements are prepared in compliance with the Philippine Financial Reporting Standards (PFRS), which is the same basis used in preparation of its General Purpose Financial Statements. The BSUP was prepared based on the activities and operations of each department within the company as of December 31, 2016.

KSPC likewise submitted an express statement manifesting the incorporation of Articles II (General Principles for Accounting Separation), III (Information Requirements for Accounting Separation), & IV (Business Segments) of the BSG for its Accounting Separation Statement. This statement clearly ensures to maintain separate accounts for each business segment.

3.1 Accounting and Cost Allocation Manual (ACAM)

KSPC developed its own ACAM to provide for a comprehensive description of the allocation methodologies employed in the accounting separation for revenues, costs, assets and liabilities. The said ACAM enumerates the accounting principles and policies that divide the accounting separation process and have been prepared in compliance with the Philippine Financial Reporting Standards and in conformity with the BSG.

3.1.1 Cost Assignment/Allocation Methodology

KSPC adopted the allocation methods and principles provided in Article III (Information Requirements for Accounting Separation) of the BSG. KSPC, also, utilized different approaches in developing its allocation methodology.

Further, KSPC applied Full Cost Absorption principle to accordingly assign costs to each business segment. As stated, a fully allocated cost consists of direct costs, indirectly attributable costs and unattributable (common) costs. Costs which are directly attributable are assigned to specific business segments while indirectly attributable and unattributable costs are assigned using the Activity-Based Costing (ABC) method. Such is defined as a costing methodology which identifies activities in an organization and assigns the resources of each

activity to all products and services according to their actual or estimated consumption.

Further, the principle of ABC is employed in the entire separation process. It is applied by tracing direct costs to the business segments. It also ensures conformance to the Full Cost Absorption principle.

3.1.2 Allocation Methodologies

KSPC adopted the following allocation factors and respective abbreviations in the preparation of its Accounting Separation Statements. In cases where costs and expenses cannot be directly traced to business segments, allocation factors are used.

	Description	Allocation Factor
For amounts directly attributable to a business segment	Balance is directly assigned to the Generation Business Segment	Generation Ratio (G)
	Balance is directly assigned to the Supply Business Segment	Supply Ratio (S)
	Balance is a reconciliation to the General Purpose Financial Statements	RECON
For amounts that are not directly traceable to a specific business segment	Ratio is derived based on the distribution of the company's production capacity to each of the business segments.	Production Capacity Distribution Ratio (PCDR)
	Ratio is based on the total number of labor hours that is spent on each business segment.	Man Hour Count Ratio (MHR)
	Ratio is based on the total amount of revenue that is earned on each business segment.	Revenue Factor (RF)

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3.1.3 Assets and Liabilities

KSPC's assets and liabilities which are directly attributable to a particular business segment will be allocated in full to the business segment in which they are acquired or incurred. On a pool of common assets and liabilities, allocation will be pooled and proportionately allocated to the other business segments on the basis of revenue for each business segment. Assets and liabilities which cannot be attributable to any business segment will be allocated in full to corporate accounts.

3.1.4 Revenues and Common Costs

KSPC applied the Full Cost Absorption principle in its cost allocation so that all costs and revenues are properly assigned to each business segment. In preparing its Accounting Separation Statements, KSPC determines amounts that are directly attributable to a business segment by identifying it as generation, supply or reconciliation to the General Purpose Financial Statements. However, for amounts not directly traceable to a specific business segment, KSPC uses the 1) Production Capacity Distribution Ratio- (PCDR) derived from the distribution of KSPC's production capacity to each business segment; 2) Man Hour Count Ratio (MHR) - based on the total number of labor hours spent on each business segment and 3) Revenue Factor (RF) - based on the total amount of revenue on each business segment.

Meantime, in cases when costs and expenses are not directly identified in each business segment, KSPC uses allocation factors.

Further, allocation of its costs starts with the identification of activity-specific and non-activity specific resources. The former is stated to be traced directly to each business segment while the latter can either be direct, indirect and unattributable. Support services like the back office, human resource and accounting services are classified as costs that are indirectly attributable or unattributable and are allocated to each business segment using various cost drivers relative to such activity.

KSPC's non-activity resources can either be direct, indirect and unattributable. Allocations of factors for the respective costs are as follows:

	Particulars	Allocation Factors
Direct costs	Purchased Power	Causation principle-revenue or cost is allocated to the activity which caused such to arise.
Indirect and unattributable costs	Salaries and Wages, gasoline, fuel and oil, utilities, purchased services, supplies, safety, events/meetings/reception, recruitment, dues/subscription, regional and cooperation, donation and contribution, environmental expense, miscellaneous expense	Identified cost drivers gathered by KSPC in determination of its resource costs and cost drivers
Depreciation expenses	Property, plant and equipment	Generation/ Supply/ MHR/ RF
Taxes other than Income Tax	Taxes, licenses, permits and final taxes on interest	Generation/ Supply/ PCDR/MHR/RF
Other Income	Market-market Gain (loss) on Derivative, Interest income, foreign exchange gain (loss), other income	Generation/ RECON/Supply/ PCDR/RF
Noncurrent Assets	Property, Plant and Equipment, Restricted Cash and Noncurrent assets	Generation/ Supply/MHR
Current Assets	Cash, Receivables, Inventories, Current portion of restricted cash and prepaid expenses and other current cash	Generation/ Supply/MHR/RF
Liabilities	Long-term loans payable, decommissioning liability, derivative liabilities, deferred tax liabilities and retirement benefit	Generation/RECON/ MHR

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	obligation	
Current Liabilities	Trade and other payables, current portion of long-term loans payable- net of deferred financing costs, due to related parties, income tax payable	Generation/ Supply/MHR/PCDR/REC ON

KSPC, as a whole, developed the allocation methodology/factor based on the principles set forth in its ACAM and the BSG.

3.1.5 Transfer Pricing Principles and Methodologies

From among the options on transfer pricing provided in Appendix H of the BSG, the transfer pricing method employed by KSPC in the preparation of the Accounting Separation Statements is based on Fully Allocated Costs method.

4. Description of Separation

KSPC identifies and records its business activities based on its business segments. Books of accounts are maintained to ensure that activities per business segments are separately recorded. If business activities cover multiple business segments, allocation methodologies and policies are adopted by KSPC to ensure that assets, liabilities, revenues and expenses from the business activities are reasonably allocated to specific business segments.

5. Milestones and Highlights

KSPC submitted its plan to be undertaken by the company involving the implementation of the separation of business segments to ensure that it is compliant with the requirements of the BSUP. It commits to implement principles and allocation methodologies as written in the ACAM. Further, it commits to enact the following after the Commission’s approval of its BSUP:

- Week 1: Accounting system update to ensure the proper implementation of the cost identification and allocation methodologies.
- Week 2: Conduct of orientation to all employees involved in BSUP.

Week 3: Organize seminars and workshops for the enhancement of knowledge of its employees.

Week 4: Involve employees on BSUP trainings.

Furthermore, it commits to continuously improve its business processes and to ensure proper monitoring or allocation of business activities per business segment.

6. Code of Conduct

KSPC undertakes to develop a plan, in compliance with the Code of Conduct for Competitive Retail Market Participants to regulate matters relating to end-users, which plan shall include training and developmental programs for employees to help ensure compliance with that code.

WHEREFORE, the foregoing premises considered, the application filed by **KEPCO SPC POWER CORPORATION (KSPC)** for the approval of its Business Separation and Unbundling Plan (BSUP) and Accounting and Cost Allocation Manual (ACAM) in accordance with the provisions of Section 36 of the EPIRA and its IRR is hereby **APPROVED**, subject to certain conditions and full compliance of the requirements of the BSG, as Amended.

Further thereto, KSPC is required to submit the following documents within five (5) months at the end of the financial year, as provided in Section 2.12, Article II of the BSG:

- a) The Accounting Separation Statements prepared by it for that period, being statements which are prepared in accordance with the approved BSUP;
- b) The Management Responsibility Statement that is required to accompany those Accounting Separation Statements;
- c) The Auditor's Report on those Accounting Separation Statements;
- d) The General Information Sheet that is required to accompany those Accounting Separation Statements;
- e) The Compliance Report that is required to accompany those Accounting Separation Statements;

In the event KSPC changes the approved ACAM, it must provide the Commission with a statement that sets out:

- a) The precise details of the proposed changes;
- b) The reasons for that change; and

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- c) The effect of that change in the Accounting Separation Statements.

SO ORDERED.

Pasig City, 21 June 2018


AGNES VST DEVANADERA
Chairperson and CEO




ALFREDO J. NON
Commissioner


GLORIA VICTORIA C. YAP-TARUC
Commissioner


JOSEFINA PATRICIA A. MAGPALE-ASIRIT
Commissioner

(On Leave)
GERONIMO D. STA. ANA
Commissioner

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