Sun Star Cebu

Sun•Star Cebu Tuesday, August 30, 2005

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

IN THE MATTER OF THE ADOPTION OF AN ALTERNATIVE FORM OF RATE SETTING METHODOLOGY FOR THE NATIONAL TRANSMISSION CORPORATION (TransCo) AND ANY FUTURE CONCESSIONAIRE THEREOF FOR THE SECOND REGULATORY PERIOD OF 2006-2010

("Application")

ERC CASE NO. 2005-_____

NATIONAL TRANSMISSION CORPORATION
(TransCo),

and

POWER SECTOR ASSETS AND LIABILITIES MANAGEMENT (PSALM) CORPORATION,
(Applicants).
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A P P L I C A T I O N

Applicants **NATIONAL TRANSMISSION CORPORATION**, ("TransCo", for brevity) and the **POWER SECTOR ASSETS AND LIABILITIES MANAGEMENT CORPORATION** ("PSALM", for brevity) through counsels, unto this most Honorable Commission, respectfully state that:

1. TransCo is a government-owned and -controlled corporation (GOCC) created by virtue of Section 8 of Republic Act No.9136, otherwise known as the "Electric Power Industry Reform Act of 2001," or the "EPIRA." It is responsible for the planning, construction, and centralized operation and maintenance of high-voltage transmission facilities nationwide, including those of grid interconnections, as well as the provision of ancillary and other related services;
2. TransCo is likewise mandated to provide open and non-discriminatory access to its transmission system to all electricity users and, accordingly, assess and collect transmission charges subject to the approval of this Honorable Commission;
3. As a System Operator, TransCo shall also provide central dispatch of all generation facilities connected, directly or indirectly, to the transmission system in accordance with the dispatch schedule submitted by the market operator, taking into account outstanding bilateral contracts;
4. Pursuant to Section 6 of the EPIRA, TransCo shall be wholly-owned by PSALM, a GOCC created pursuant to Section 49 of the EPIRA;
5. Pursuant to Section 43(f) of the EPIRA, the Energy Regulatory Commission (ERC) developed, approved and adopted the Guidelines on the Methodology for the Setting of Transmission Wheeling Rates (TWRG), a new methodology for setting the transmission wheeling rates of TransCo based on the Maximum Annual Revenue (MAR) Cap. The TWRG was promulgated on May 29, 2003;
6. Article VII, (Regulatory Reset Process) of the TWRG sets forth the process that the ERC will follow in determining the price control arrangements that are to be made applicable for the Second Regulatory Period. On September 20, 2004, the ERC, consistent with Section 7.1.2 of the TWRG, published a Regulatory Reset Issues Paper (Issues Paper) to:
   (a) Provide the ERC's initial views on the issues to be discussed during the Regulatory Reset Process;
   (b) Guide TransCo in preparing the information required to be delivered by TransCo for the purposes of the Regulatory Reset Process; and
   (c) Specify the time by which such information shall be delivered;
7. Section 1.2.2 of the Issues Paper requires TransCo to submit to the ERC as filing for the Regulatory Reset, including all data, reports, forecast and information required by the TWRG for this process, not later than August 31, 2005. This Application, and its supporting annexes and attachments, fulfill that requirement. These reports, assumptions and the approach taken by TransCo in the preparation of this filing are summarized in Annex "A";
8. Article VII of the TWRG requires that the filing include independent expert reports with respect to each of the following:
   (a) An asset re-valuation referred to in Section 4.6 of the TWRG. This requirement is met by Asset Re-valuation Report prepared by Sinclair Knight Merz (SKM) in association with PricewaterhouseCoopers (PwC), and Cuervo Appraisers, Incorporated (for convenience referred to as "SKM et. Al."), hereto attached as Annex "B" to form part of this submission;
   (b) A report on the condition and lives of assets that are used in providing regulated transmission services and referred to in Section 4.8.2 of the TWRG. This requirement is the report prepared by SKM et. Al., hereto attached as part of Annex "B";
   (c) A determination of the Weighted Average Cost of Capital (WACC) referred to in Section 4.9 of the TWRG. The Applicants have complied with this requirement through the report prepared by Professor Tony van Zijl, Ph.D., professor of Accounting and Finance at Victoria University, with a Doctorate in Finance, and Director of LECG, hereto attached as Annex "C";
   (d). A review of the Regulated Entity's proposed capital expenditure (CAPEX) referred to in Section 4.10 of the TWRG. Applicants have complied with this requirement through the report prepared by SKM, hereto attached to form part of this submission as Annex "D";
   (e) A review of the Regulated Entity's proposed operating and maintenance expenditure (OPEX) referred to in Section 4.11 of the TWRG. Applicants have complied with this requirement through the report prepared by SKM, hereto attached to form part of this submission as Annex "E".
9. In their desire to assist this Honorable Commission, the Applicants likewise engaged the services of an independent taxation expert, Atty. Edmundo F. Guevara, former Deputy Commissioner of the Bureau of Internal Revenue (BIR) and with countless local and foreign contributions on the matter of taxation, to provide an opinion on the taxes for which TransCo and the prospective concessionaire may be held liable. Atty. Guevara's report is attached hereto to form part of this submission as Annex "F".
10. Article IV of the TWRG provides that TransCo submit to the ERC, in addition to the experts' reports identified above, the following information and forecasts:
   (a) The Regulated Entity's forward forecasts of its proposed annual capital expenditure for each Regulatory Year in the Second Regulatory Period. Applicants have complied with this requirement through the forecasts summarized in Annex "A", and the detailed forecasts in the format requested by the ERC in its Issues Paper, which are set out in Schedule 1 of Annex "A";
   (b) The Regulated Entity's historical operating and maintenance expenditure for each of the three (3) calendar years preceding the commencement of the Secondary Regulatory Period. This requirement is met with actual data for 2003, 2004 and estimated data for 2005. This information is summarized in Annex "A", and the detailed information in the format requested by the ERC in its Issues Paper, is set out in Schedule 2 of Annex "A".
   (c) The Regulated Entity's forward forecasts of its proposed annual operating and maintenance expenditure for each Regulatory Year in the Second Regulatory Period. Applicants have complied with this requirement through the forecasts summarized in Annex "A", and the detailed forecasts in the format requested by the ERC in its Issues Paper, set out in Schedule 3 of Annex "A";
   (d) A summary of the Regulated Entity's historical payments of taxes, levies and duties (other than corporate income tax) for each of the three (3) calendar years preceding the commencement of the Second Regulatory Period. Applicants have complied with this requirement with actual data for 2003, 2004 and estimated data for 2005. This information is summarized in Annex "A", and the detailed information in the format requested by the ERC in its Issues Paper, is set out in Schedule 4 of Annex "A";
   (e) The Regulated Entity's forward forecasts of its expected payments of taxes, levies and duties (other than corporate income tax) for each Regulatory Year in the Second Regulatory Period. Applicants have complied with this requirement through the forecasts summarized in Annex "A", and the detailed forecasts in the format requested by the ERC in its Issues Paper, set out in Schedule 5 of Annex "A";
11. In compliance with the Issues Paper, the Applicants have also obtained independent expert advice, and prepared supporting information and analyses on the following matters:
   a. Matters pertaining to the roll forward of the initial Regulated Asset Base (RAB) as of December 31, 2004 up to December 31, 2005. This report prepared by SKM et al., hereto attached as part of Annex "B", complies with the requirement;
   b. Matters pertaining to the roll forward of RAB as of December 31, 2005 to the end of the Second Regulatory Period (Sections 4.7 and 4.8, TWRG). These matters are discussed in Annex "A".
   c. Matters relating to service quality measures and targets, including a performance incentive scheme (Article VIII, TWRG), are summarized in Annex "A", and supported by Schedule 6 of Annex "A";
   d. The issues identified in Chapter 8 of the Issues Paper are discussed in Annex "A";
   e. Information regarding TransCo and PSALM's services, business processes and cost drivers, is provided in Annex "A".
12. To assist the Commission in evaluating this application and the supporting information and expert reports, TransCo commissioned a pool of independent experts led by Mr Kieran Murray, to build a computerized model. This model calculates the efficiency factor and price path Smoothed Maximum Allowable Revenue (SMAR) for each year of the Second Regulatory Period. It provides for the outcomes and advice of the experts, or alternative assumptions, to be modeled. The model is capable of calculating the efficiency factor and price path under a range of values and scenarios for the major building blocks. The model is summarized in Annex "A", and an electronic copy of the model is provided in Schedule 7 of Annex "A".
13. Annex "A" also sets out the following:
   (a) Applicants' interpretation and understanding of the Second Regulatory Reset and its underlying principles and objectives;
   (b) The key assumptions, statements, calculations, and declarations made in order to come up with a preliminary indication of the Maximum Allowable Revenue (MAR) for the Second Regulatory Period, and the Annual Revenue Requirement (ARR) for each year within that five (5) - year period;
   (c) Applicants also provide position and comments on the following issues:
      c.1 Treatment of CWIP
      c.2 Treatment of working capital
      c.3 Tax timing issues
      c.4 Efficiency carry-forward mechanism
      c.5 Form of regulation
14. The following tables summarize the key forecasts and information submitted by TransCo and the results obtained from the MAR model.
   (a) The table below sets out the proposed annual capital expenditures (CAPEX) of TransCo from CY 2005 to 2010:

Capex (in Millions)	2004 Actual	2004 Actual	2005	2006	2007	2008	2009	2010
	Year Ended		Estimated	Projected (in Millions)				
Exchange Rate				56.00	55.00	51.00	50.00	49.00
In US$	4.7	14.2	10.8	11.00	10.00	7.00	4.00	3.00
In Pesos	3,383.1	1,014.6	1,287.0	1,199.0	1,127.0	1,296.0	1,261.0	1,249.0
Total Capex	3,387.8	1,028.8	1,297.8	1,210.0	1,137.0	1,303.0	1,265.0	1,252.0
Depreciation	123.2	143.3	151.6	202.7	196.8	190.9	185.1	179.4
Total Capex	3,264.6	885.4	1,146.2	1,007.3	940.2	1,112.1	1,079.9	1,072.6

Note: Capex Expected to be Approved for Recovery in Year 2006 Will be Depreciated Over 20 Years, Following the Year of Capex to Which Expected to be Commissioned and Ready for Use.

   (b) To rationalize its proposed operating and maintenance expenditures, TransCo modified its forecast operating expenditure. Accordingly, the forecast operating expenditure proposed for this filing is set out in the table below.

Revised Opex Forecast (PhP Mn, Nominal)

	2005	2006	2007	2008	2009	2010
Exchange Rate (PhP/US$)	56.00	55.00	51.00	51.00	50.00	49.00
CPI USA	3.2%	2.9%	2.9%	2.9%	2.9%	2.9%
CPI Philippines	5.3%	7.7%	5.4%	4.9%	4.8%	4.9%
Total Operating & Maintenance Expenditure	4,437	4,874	5,973	5,174	7,228	7,694

   (c) The table below sets out the assumptions used by the Applicants in the calculation of the applicable taxes, levies, and duties:

Taxes	Tax Rate	Basis
1. Income Tax	35% in 2005 to 2007 - 30% 2008 to 2010 - 30%	Taxable net income in preceding period (Link part of 3007, 2007 paid in 2008, etc.), as per TWRG requirements. Adjustment to working capital for Rate Set purposes.
2. Franchise Tax		
3. Business Tax	0%	
a. Gross Receipts Tax	7% of 1%	Gross receipts of the preceding year
b. Value Added Tax		
4. Local Business Tax		Gross receipts of the preceding year
5. Other Taxes		Taxes from the Regulatory Finance
a. Local Transfer Tax	75% of 1%	Gross Receipts of the preceding
b. PST		

   (d) The table below sets out the assumptions used by the Applicants in the calculation of the applicable taxes, levies, and duties:

Taxes	Tax Rate	Basis
		year
Concessionaire	75% of 1%	- Gross Receipts of the preceding year of the Concessionaire
6. Other taxes		
a. Local transfer tax	75% of 1%	- Cost of the New Projects
b. PST	P15 for every P1,000	- Inputs from Transco Finance

   (e) The value of the RAB over the Second Regulatory Period with adjustments is forecast in the table below:

Particulars (PhP, Mn)	2005	2007	2008	2009	2010
RAB	154,843.7	164,993.7	176,152.4	180,937.5	180,691.8
RAB Depreciation	4,994.2	4,994.2	4,994.2	4,994.2	4,963.3
Capex	11,837.2	17,203.3	10,988.6	6,157.3	5,045.3
Disposals	997.7				
Cover Reserve	449.6	900.4	1,307.4	1,419.1	1,436.2
RAB	154,843.7	176,152.4	180,937.5	180,691.8	179,715.7

Note: Assumed WACC of 12.9% as recommended by Independent Expert, Prof. Tony Van Zijl, Ph.D.

   (f) The proposed performance indicators and the corresponding weights are set out in the table below. The proposed weightings are based on an assessment of the impacts of the different performance indicators for and users.

Performance Indicator	Weighted Percentage, %
1. System Interruption Severity Index (SISI)	30
2. Frequency of Tripping per 100 ckt-km (FOT/100ckt-km)	25
3. System Availability (SA)	25
4. Frequency Limit Compliance (FLC)	10
5. Voltage Limit Compliance (VLC)	10

15. In securing the independent experts and experts' reports referred to above, the applicants adhered strictly to Article VII of the TWRG and Section 53 of the Implementing Rules and Regulations (IRR) of Republic Act No. 9184, otherwise known as the "Government Procurement Reform Act." The said independent experts were provided by TransCo and PSALM with full cooperation and support, in the form of extensive information, full access to premises, records and assets, and reasonable funding, pursuant to Section 14.3 of the TWRG;
   They were evaluated on the basis of Article XIV and Appendix B of the TWRG. The selection process strictly observed transparency, integrity, fair play, and the absence of any conflicts of interest;
16. This submission is with the approval of the respective Boards of Directors (BODs) of TransCo and PSALM. Attached hereto as Annexes "G" and "H", respectively, are the resolutions of the TransCo and PSALM Boards approving this submission;
17. In compliance with the requirements of Section 4 (c) of Rule 3 of the Implementing Rules and Regulations (IRR) of the EPIRA, this Application has been published in a newspaper of general circulation and the Office of the Quezon City and Makati City local governments have been provided with the copy of this Application;
18. This Application, and the supporting annexes and attachments, comprise the filing required of the "Regulated Entity" (that is TransCo), for the Second Regulatory Period;
19. The following proposals for the Second Regulatory Period (2006-2010), to wit:
   i. Optimized Depreciated Replacement Cost of TransCo's Regulatory Asset Base (RAB) rolled forward from 2004 to 2010;
   ii. Forecast Capital Expenditures (CAPEX);
   iii. Forecast Operating and Maintenance Expenditures (OPEX);
   iv. Tax Items and Assumptions;
   v. Working Capital;
   vi. Performance Incentive Schemes;
   vii. WACC as recommended by Professor Tony Van Zijl, Ph.D.,

   are designed and developed in accordance with the provisions of the TWRG and the Regulatory Reset Issues Paper as would lay down a basis for fair and reasonable set of smoothed MARs for the Second Regulatory Period that will serve the public interest and convenience and signal the efficient utilization of transmission facilities that will ultimately redound to the best interest and benefit of the consumers.

P R A Y E R

WHEREFORE, it is most respectfully prayed of this Honorable Commission to approve the following in the Commission's determination of the set of smoothed Maximum Allowable Revenues (MAR) for the second regulatory period:

(i) Optimized Depreciation Replacement Cost of TransCo's rolled forward Regulatory Asset Base (RAB) from 2004 to 2010;
(ii) The Forecast Capital Expenditures (CAPEX)
(iii) The Forecast Operating and Maintenance Expenditures (OPEX)
(iv) The Working Capital Proposals
(v) The Tax items and assumptions
(vi) The Performance Incentive Schemes

In addition, Applicants also respectfully pray to this Honorable Commission to consider the expert's report on Average Cost of Capital (WACC) in the calculation of TransCo's set of smoothed Maximum Allowable Revenues (MAR) for the Second Regulatory Period, commencing January 2006.

Applicants pray for other reliefs deemed just and equitable under the premises.

Quezon City and Makati City for Pasig City, August 29, 2005.

NATIONAL TRANSMISSION CORPORATION
(Transco)

POWER SECTOR ASSETS AND LIABILITIES MANAGEMENT CORPORATION (PSALM)

VERIFICATION AND CERTIFICATION

(Republic of the Philippines)
(Quezon City) S.S.

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