

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



**IN THE MATTER OF
PETITION FOR RULES
CHANGE IN RATE SETTING
METHODOLOGY FOR
DISTRIBUTION WHEELING
RATE – REPEAL OF THE
PERFORMANCE-BASED RATE
MAKING (PBR) REGULATION
AND RETURN TO PREVIOUS
RETURN-ON-RATE-BASE
(RORB) WITH
MODIFICATION**

ERC CASE NO. 2015-008 RM

**MATUWID NA SINGIL SA
KURYENTE CONSUMER
ALLIANCE, INC. (MSK),
Petitioner.**

X ----- X

D O C K E T E D
Date: **DEC 02 2016**
By: *W*

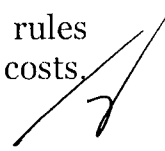
ORDER

On 22 December 2015, the Matuwid na Singil sa Kuryente Consumer Alliance, Inc. (MSK) filed a Petition for rules change in rate setting methodology for Distribution Wheeling Rate – repeal of the Performance-Based Rate Making (PBR) Regulation and return to previous Return-on-Rate-Base (RORB) with modification.

In the said Petition, MSK alleged the following:

THE PARTIES

1. MSK is a non-stock/nonprofit non-governmental organization (NGO) duly organized and existing under the laws of the Republic of the Philippines, with office address at Unit 327, Eagle Court Condominium, #26 Matalino Road, Brgy. Central, Diliman, Quezon City, where it may be served with pleadings and processes of this Honorable Commission. MSK has been formed by concerned Meralco consumers to enlighten the public and policy makers on the specific rules and practices that have been causing the abusive power costs.



It is represented herein by its Executive Director, EVELYN VIRAY-JALLORINA, who is duly authorized to file this petition. Attached is **Annex "A"**, a copy of Secretary's Certificate authorizing MS. JALLORINA to represent MSK.

2. ERC has been created under Executive Order No. 172, (as amended) as an independent, quasi-judicial regulatory body tasked to promote competition, encourage market development, ensure customer choice and penalize abuse of market power in the electricity industry. ERC may be served with pleadings at Pacific Center Building, San Miguel Avenue, Ortigas Center 1600 Pasig City, Metro Manila, Philippines.

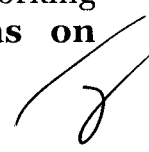
3. Manila Electric Company (MERALCO) is the country's largest electric distribution company with address at Meralco Compound, Lopez Building, Ortigas Avenue, Pasig City.

I. CONTEXT

The Energy Regulatory Commission promulgated on December 10, 2004 the Guidelines on the Methodology for Setting Distribution Wheeling Rates (DWRG). These were subsequently updated and re-issued on July 26, 2006 as the Rules for Setting Distribution Wheeling Rates for Privately Owned Distribution Utilities (RDWR) entering Performance Based Regulation.

Supposedly these new rules were promulgated by the ERC pursuant to Section 43(f) of Republic Act 9136 and Rule 15 Section 5(a) of its Implementing Rules and Regulations (IRR) which authorized the ERC to adopt alternative forms of internationally accepted rate setting methodology which must ensure a reasonable price of electricity.

ERC's RDWR provides for a performance-based regulation using a price cap to set the distribution wheeling rates to be charged by Distribution Utilities to its customers. For all its complexities, the PBR (Performance Based Rate Setting) allows for recovery and returns on installed assets used in providing the services to the consumers called regulatory asset base as in the previous return on rate base (RORB) methodology that it supposedly alternated for, plus projected operating expenses, working capital, **AND added the recovery and returns on forecasted investments.**



II. ISSUES

1. UNREASONABLE PRICE

With all these added cost and return recovery elements, the distribution rate to Meralco's consumers jumped significantly since the adoption of the PBR in the 2nd half of 2007. PBR did not result to a reasonable price of electricity and has not been in the public interest.

2. FORECASTED, NOT "INCURRED" INVESTMENTS

Worse, the ERC rules including the RDWR do not appear to provide for validation that the forecasted investments were actually made to improve services hence making the consumers pay for capital investments that may not have been actually made. Meralco consumers not only were subjected to institutionalized overcharging but were left naked and defenseless from abuse from more overcharging, a dereliction of ERC's mandate to safeguard the public interest.

PBR did not improve on the RORB.

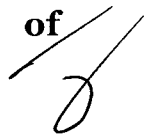
3. UNTRUSTWORTHY TRACK RECORD

Meralco's track record in padding their Rate Base does not justify trust.

The PBR methodology relies on the DU like Meralco to do a lot of forecasts on the demand, cost of service, required investments, and etc. Unfortunately, Meralco's track record of padding does not engender consumer trust. They have consistently been caught many times with their hands in the cookie jar padding their rate base under the old RORB system. In their PBR application in 2007 their attempts at padding and overcharging were even bolder and brazen based on the audit report of ERC's own regulatory reset expert consultants Parsons Brinkerhoff Associates (PB Associates). We only have to read the PB Associates report to see the harrowing chronicle of Meralco's cunning and outright attempts at padding their charges to their captive consumers.

Allow us to cite some examples from the PB Associates findings:

- a. Claim for "Additional Expenditures" of P2.463 billion**



Meralco was claiming additional expenditures totalling P2.463 billion over four years from 2008 to 2011.

1. This included **P1.839 billion for “regulatory compliance”** activities covering “PBR, the Magna Carta, DSOAR, Business Separation Guidelines and other guidelines and rules that the ERC will implement in the immediate future”.

2. Even the ERC consultants noted that

a) “these are generally **normal business processes and activities that a well managed distribution business should be routinely undertaking**”

b) “no details for the additional work were provided other than very general comments”

c) “Meralco has not provided details of the methodology used to quantify the additional regulatory compliance work as a result of new regulatory requirements, no its estimate of the additional work load in staff numbers, nor was any information provided as to the capability of existing staff to cope with a proportion, if any, of the additional work load.”

3. Consequently the **foreign consultants of ERC recommended only P320 million of the P2.463 billion requested or 87% less.**

4. The ERC however disagreed with the consultants conclusion to be “inappropriately harsh”. In Table 5.10 of its final determination dated August 30, 2007, **the ERC approved a total of P358.2 million over the five year period from 2007 to 2011. This was 12% or P38.2 million higher than the consultants recommendation.**

5. **Ironically, Meralco would charge the consumers for its cost of finding legal and tricky justifications to confuse and overcharge the consumers.**

b. Purchase of Distribution Transformers from Lopez Companies

1) PB Associates had observed that “**there appears to be excessive provision for distribution**”



transformers leading to under-utilization”
(p.23, 4.5.2)

2) Meralco claims that it has 147,930 units of distribution transformers with an average loading of 50%. Meralco also claimed that 6,080 of these transformers in their network serve solely-served customers whose average usage is under 50%.

3) **The ERC reduced the expenditure for distribution transformers proposed by Meralco by a total of P1.446 billion** for the two years 2010 and 2011 because it would further reduce Meralco’s utilization of distribution transformers below the 50% allowed for in the ERC’s asset valuation policy guidelines.

4) The Lopez group owns the **Philec** Transformer Factory and preferred vendors enjoy substantial contracts for imported distribution transformers.

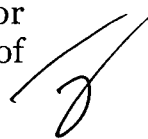
c. Anomalous Metering Expenditures and Refurbishment

a) The findings of the consultants on Meralco’s claims for meter expenditures showed disturbing manipulations (p.5 and 6 of PB Associates Report)

1. “Meralco provided supporting information that provides a breakdown of the 1,360,728 “excess” meters identified by PB Associates and shows an actual inventory of only 87,266 meters. **We note that even though none of these meters existed, they remain on Meralco asset register.** It is of concern that the **1,261,000 meters** in these categories were still on the Meralco asset register at the time of the asset valuation. We suggest that the ERC require Meralco to cleanse the asset register of all non existent or unserviceable metering assets.”

2. “the information provided indicates that Meralco purchases approximately 206,000 new meters a year (excluding metering transformers) to support load growth. However, Meralco connects only approximately 97,000 new customers each year.”

3. Meralco is charging P518 million in 2008 for meter refurbishment costs. At an average cost of



P52 per meter which means this involves recalibration only. This must be included in regular operating costs and not capitalized.

4. Meralco owns a substantial ownership in local meter company GE Meters.

5. The Consultants and the ERC reduced Meralco's budget for meters by **P1.43 billion** for the four years that presumably would have gone to income of its sister company GE Meters.

d. Over budgeting the Costs of Service Drops

Meralco was determined to be overcharging the service drops by P433 million because its actual service length is only 7.5 meters instead of the 30 meters it is claiming.

e. Other Overcharging Attempts

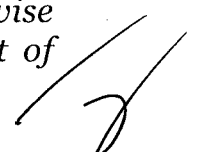
- a. P2.87 billion of Meralco forecast capex for asset renewal could not be supported and was disallowed.
- b. A total of P323 million was disallowed for the over recovery of stores costs.
- c. P730 million that Meralco spends for "related business income" and it tried to pass on as utility expense was disallowed.

And these attempts were after Meralco had been caught many times padding their rate base with expenses of the Meralco theatre, a luxury resort in Antipolo, high prices on material purchases from sister company vendors of transformers, meters, concrete poles, transmission lines, engineering services, and computer systems.

4. UNFAIR AND ILLEGAL

- a. ERC's approval document for Meralco's Regulatory Reset for July 2007 to June 2011 (Second Regulatory Period) issued on August 30, 2007 and its approval of the Regulatory Reset for July 2011 to June 2015 (Third Regulatory Period) premised the legal basis for the PBR under Section 1.1 of those documents as

"Section 43(f) of Republic Act No. 9136, otherwise known as the Electric Power Industry Reform Act of



2001 (EPIRA) and Rule 15, Section 5(a) of its Implementing Rules and Regulation (IRR), authorized the ERC to adopt alternative forms of internationally accepted rate-setting methodology”

The legal basis is conveniently selective, inaccurate, flawed, and anti-consumer.

- b. The full provision of Section 43(f) of the EPIRA preceded the law as follows: **“in the public interest, establish and enforce a methodology for setting transmission and distribution wheeling rates and retail rates for the captive market of a distribution utility taking into account all relevant considerations, including the efficiency or inefficiency of the regulated entities”**. Emphasis must be made on “in the public interest”.
- c. Section 43(f) is that part of the EPIRA law that defined the power, authority, and responsibilities of the Energy Regulatory Commission. Emphasis must be made on the clear prerequisite that any rate setting methodologies adopted by the ERC must be **“in the public interest”**. The Section also required that any alternative method of rate setting **must result to a reasonable price of electricity. (Annex “B”)**.
- d. For a rate-setting methodology to be “in the public interest” it must benefit the public and result to an improvement from the current one which was the RORB. The benefit to the public can either be in a) lower or more reasonable price of electricity and/or b) improvement in efficiency of service to the captive customers. Something that improved efficiency but at significant and unreasonable costs to the consumers would not be in the public interest.
- e. **It is our position that charging consumers for investments that have not yet been incurred including returns on those forecasted investments as allowed by the PBR methodology, is unfair and UNREASONABLE.**
- f. **PBR is an even clearer violation of the law under Section 25 of the EPIRA law that required that the retail rates must be based on investments incurred.**



Sec. 25. Retail Rate. – The retail rates charged by distribution utilities for the supply of electricity in their captive market shall be subject to regulation by the ERC based on the principle of full recovery of prudent and reasonable economic costs incurred, or such other principles that will promote efficiency as may be determined by the ERC.

The current rules of PBR allow for the charging to the consumers Meralco's projected investments and returns on them. These have not yet been incurred and there is no assurance that they will be incurred. Inclusion of these projections on the retail rate to the consumers is therefore unfair and illegal.

The right of ERC to adopt alternative rate setting methodologies is predicated on such alternatives to be in the public interest.

III. PROPOSED MODIFICATION OF THE RATE SETTING METHODOLOGY

MSK sympathizes with the DU complaint on the drawback of the old RORB system that the time it takes to get approval for recovery of investments creates a regulatory lag discourages timely investments to improve performance and DU efficiency.


Going to the other extreme which is allowing recovery of projected investments without validation of whether they were actually made is unjustified and most unfair to the consumers.

We propose a Modified RORB or even Modified PBR where the capex and its rate recovery are approved in advance but the charges to the consumers will only start after the investments have actually been made and validated by the ERC auditors. In this way, the requirement of Section 25 for recovery only of investments actually incurred is complied with.

We also propose as part of this that the ERC install a system of continually auditing Meralco as part of the vigilant system to safeguard consumers from abuse.

In a nutshell, MSK begs to hear from respondents the answers to the following:

1. Is the PBR method within the "public interest" mandate of ERC?



2. Is the PBR legal in view of the requirement of Section 25 of the Epira Law that the investments or economic costs must be incurred? Do the projected investments being charged to the consumers qualify as investments incurred?
3. Did the PBR comply with the law's requirement that the resulting rate must be reasonable?
4. Would our proposed modification to require that the investment must be "incurred" first before the consumers can be charged for it cure the legal infirmity and offer sufficient protection to consumers from overcharging?

PRAYER

WHEREFORE, premises considered, it is respectfully prayed to the Honorable Commission:

- To modify the PBR methodology, it being **INFIRM AND ILLEGAL**, and results to overcharging of consumers.
- For ERC to install a system of continually auditing Meralco as part of the vigilant system to safeguard consumers from abuse.
- To schedule a public hearing preferably in the last week of January 2016 on this urgent matter so that relevant issues can be heard and the Honorable Commission can promptly correct the flaws and injustice of the PBR rate making methodology.
- Other relief equitable under the premises are likewise prayed for.

Finding the said Petition sufficient in form and substance with the required fees having been paid, the same is hereby set for public consultation on **9 January 2017 (Monday) at two o'clock in the afternoon (2:00 P.M.) at the ERC Hearing Room, 15th Floor, Pacific Center Building, San Miguel Avenue, Pasig City.**

The Commission shall cause the posting of the attached Notice of Proposed Rule-Making at its official website at www.erc.gov.ph.

All interested parties are hereby directed to submit their comments on the petition for rules change in rate setting methodology for distribution wheeling rate – repeal of the performance-based rate making (PBR) and return to previous return-

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on-rate base (RORB) with modification on or before 26 December 2016.

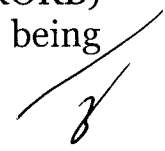
MSK is hereby directed to cause the publication of the attached Notice of Proposed Rule-Making, at its own expense, once (1x) in a newspaper of general circulation in the Philippines, with the date of the publication to be made not later than two (2) weeks before the date of the scheduled public consultation.

MSK is directed to furnish all those making requests therefor with copies of the petition for rules change in rate setting methodology for distribution wheeling rate – repeal of the performance-based rate making (PBR) and return to previous return-on-rate base (RORB) with modification, subject to reimbursement of reasonable photocopying costs.

On the date of the public consultation, MSK must submit to the Commission its written Compliance with the jurisdictional requirements attaching therewith, methodically arranged and duly marked, proofs of the actual publication of the Notice of Proposed Rule-Making, consisting of an affidavit of the Editor or Business Manager of the newspaper where the said Notice of Proposed Rule-Making was published, together with the complete issue of the said newspaper, and such other proofs of compliance with the requirements of the Commission.

Let copies of the Petition, this Order and the attached Notice of Proposed Rule-Making be furnished the Office of the Solicitor General (OSG), the Commission on Audit (COA), and the Committees on Energy of both Houses of Congress. They are hereby requested, if they so desire, to send their duly authorized representatives at the scheduled hearing.

MSK must also be prepared to make an expository presentation of its petition for rules change in rate setting methodology for distribution wheeling rate – repeal of the performance-based rate making (PBR) and return to previous return-on-rate base (RORB) with modification, aided by whatever communication medium that it may deem appropriate for the purpose, in order to put in plain words and explain, for the benefit of the consumers and other concerned parties, what the petition for rules change in rate setting methodology for distribution wheeling rate – repeal of the performance-based rate making (PBR) and return to previous return-on-rate base (RORB) with modification is all about and the reasons and justifications being cited in support thereof.



SO ORDERED.

Pasig City, 7 November 2016.

FOR AND BY AUTHORITY
OF THE COMMISSION:


JOSE VICENTE B. SALAZAR
Chairman and CEO

LS:  JHB/ARG/NNM

Copy Furnished:



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