



Annex “A”

**RULES FOR SETTING DISTRIBUTION
WHEELING RATES**

for

**PRIVATELY OWNED ELECTRICITY
DISTRIBUTION UTILITIES**

**OPERATING UNDER PERFORMANCE
BASED REGULATION**

**(FIRST ENTRY GROUP :
THIRD REGULATORY PERIOD)**

[December 1, 2009]

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Republic of the Philippines
Energy Regulatory Commission

Pacific Center, San Miguel Avenue, Pasig City

RULES FOR SETTING
DISTRIBUTION WHEELING RATES
for
PRIVATELY OWNED ELECTRICITY DISTRIBUTION UTILITIES
OPERATING UNDER PERFORMANCE BASED REGULATION

(FIRST ENTRY GROUP :
THIRD REGULATORY PERIOD)

Pursuant to Section 43(f) of Republic Act No. 9136, otherwise known as the Electric Power Industry Reform Act of 2001, and Rule 15, Section 5(a) of the Implementing Rules and Regulations issued pursuant to that Act, the Energy Regulatory Commission (ERC) hereby promulgates the following Rules for the setting of distribution wheeling rates for privately owned distribution utilities operating under performance based regulation and entering the First Entry Point for the Third Regulatory Period, based on Annex B of ERC Resolution No. 12-02 Series of 2004 “Adopting a Methodology for Setting Distribution Wheeling Rates”, dated December 10, 2004. This set of Rules is an amendment to the initial Guidelines on the Methodology for Setting Distribution Wheeling Rates, published by the ERC on December 10, 2004.

This document applies to the First Entry Group of privately owned distribution utilities, for the Third Regulatory Period only. A set of Rules for Setting Distribution Wheeling Rates will be issued for each of the other (three) Entry Points for privately owned electricity distribution utilities entering performance based regulation in the Third Regulatory Period, where the Entry Points were defined in Annex B of the afore-mentioned Resolution 12-02 Series of 2004, subsequently amended by the ERC as noted in Appendix E to these Rules.

**RULES FOR SETTING
DISTRIBUTION WHEELING RATES**

for

**PRIVATELY OWNED ELECTRICITY DISTRIBUTION UTILITIES
OPERATING UNDER PERFORMANCE BASED REGULATION**

**(FIRST ENTRY GROUP :
THIRD REGULATORY PERIOD)**

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ARTICLE I
GENERAL PROVISIONS

1.1 Purpose

- 1.1.1 The purpose of these Rules is to set out the methodology to be used in setting the maximum distribution wheeling rates that may be charged for the provision of Regulated Distribution Services by Regulated Entities making up the First Entry Point for privately owned electricity distribution utilities operating under performance based regulation during the Third Regulatory Period, where the Entry Points were originally defined in Annex B of ERC Resolution No. 12–02, Series of 2004 “Adopting a Methodology for Setting Distribution Wheeling Rates”, dated December 10, 2004 and later amended to four Entry Points under ERC Resolution No. 24, series of 2007, dated October 24, 2007 and subsequently further amended under ERC Resolution No. 20, dated December 8, 2008. The entry groups are noted in Appendix E to these Rules.
- 1.1.2 This set of Rules is an updated version of the original Distribution Wheeling Rate Guidelines issued by the ERC on December 10, 2004, as subsequently amended in the Rules for Distribution Wheeling Rates (RDWR), re-issued at several dates.
- 1.1.3 A version of the RDWR will be issued for each Entry Point in the Third Regulatory Period, to reflect the dates relevant to that particular Entry Point.

1.2 Content of the Rules

- 1.2.1 These Rules set out:
- (a) the methodology to be used in setting the maximum distribution wheeling rates that may be charged for the provision of Regulated Distribution Services by Regulated Entities during the Third Regulatory Period;
 - (b) the pricing principles with which the ERC must comply for the purposes of regulating the maximum distribution wheeling rates that may be charged for the provision of Regulated Distribution Services by all Regulated Entities during a Subsequent Regulatory Period;
 - (c) the annual rate verification and adjustment process which the ERC must undertake in relation to the maximum distribution wheeling rates that may be charged for the provision of Regulated Distribution Services by such Regulated Entities during a Regulatory Period;
 - (d) the regulatory processes and timelines to which both Regulated Entities and the ERC must adhere in order for the methodology established by these Rules to be administered and applied in a timely manner; and
 - (e) the performance indicators, performance targets and reporting arrangements with which all Regulated Entities must comply during the Third Regulatory Period and each Subsequent Regulatory Period, and which the ERC must monitor, in order to ensure the effective and efficient delivery of Regulated Distribution Services to consumers.

1.3 Definitions

In these Rules, unless the contrary intention appears, the following words and phrases have the following meanings:

Affected Regulated Entity	(a) In relation to a Force Majeure Event, a Regulated Entity which (as a result of that Force Majeure Event) incurs, or is likely to incur, an increase in costs as referred to in the definition of "Force Majeure Event"; and (b) in relation to a Tax Change Event, a Regulated Entity which (as a result of that Tax Change Event) incurs materially higher or lower costs as referred to in the definition of "Tax Change Event".
Ancillary Services	Those services that are necessary to support the transmission of capacity and energy from resources to loads while maintaining the reliable operation of the Grid or a Distribution System or a Subtransmission System in accordance with good utility practice, the Grid Code and the Distribution Code. These include the services rendered by generation facilities that are dedicated to providing emergency standby power during emergency situations, where the normal operating conditions of a Distribution System are compromised due to bulk supply factors beyond the control of a Regulated Entity.
Application Year	The Regulatory Year denoted as the Application Year in Section 6.2.1.
Approved Force Majeure Pass Through Amount	The lesser of a Force Majeure Pass Through Amount proposed by an Affected Regulated Entity in relation to a Force Majeure Event and the Eligible Force Majeure Pass Through Amount in respect of that Force Majeure Event as referred to in Section 10.3.1(b).
Approved Tax Pass Through Amount	The lesser of a Positive Tax Pass Through Amount proposed by an Affected Regulated Entity in relation to a Tax Change Event and the Eligible Tax Pass Through Amount in respect of that Tax Change Event as referred to in Section 11.2.2(b).
Business Day	A day other than a Saturday or a Sunday or an official Philippine national public holiday.
Business Separation Guideline	The Guideline promulgated by the ERC under Rule 10, Section 1 of the IRR as promulgated by the ERC on September 22, 2003 under ERC Case No. 2003-46, Resolution No. 49, Series of 2006 as amended, to provide the framework and rules for the structural unbundling of the business activities of electric power industry participants.

Rules for Setting Distribution Wheeling Rates
First Entry Group : 3rd Regulatory Period

Captive Market	Electricity end-users connected to the Regulated Distribution System of a Regulated Entity who receive their electricity Retail Services from the Regulated Entity in a non-competitive environment, where there is no economically competitive option of sourcing these services from alternative suppliers.
CPI	The All Items Consumer Price Index published by the National Statistics Office of the Philippines.
Customer	<p>In respect of a Regulated Distribution System:</p> <ul style="list-style-type: none">(a) a person whose User System or Equipment is directly connected to the Regulated Distribution System and who purchases or receives, or who is seeking to purchase or receive, Regulated Distribution Services in respect of that Regulated Distribution System; and(b) any other person who purchases or receives, or who is seeking to purchase or receive, Regulated Distribution Services in respect of that Regulated Distribution System. <p>For the avoidance of doubt, this may include a person who operates an Embedded Generator, a Retail Electricity Supplier (RES) or an End-user.</p>
Customer Segment	In relation to a Regulated Distribution System, a category of Customers of that Regulated Distribution System which is approved by the ERC. For these purposes, a category of Customers will comprise Customers of the relevant Regulated Distribution System which have similar consumption characteristics for Regulated Distribution Services in respect of that Regulated Distribution System, based on their geographic location and consumption profile, as measured by the number of connections, the energy throughput (kWh), the non-coincident peak load (kW), the co-incident peak load (kW), the time-of-day or any other physical measure as approved from time to time by the ERC. A Customer Segment in respect of a Regulated Distribution System is likely to include all of the Customers of that Regulated Distribution System who are charged the same tariff by the Regulated Entity which operates that Regulated Distribution System for the provision of Regulated Distribution Services in respect of that Regulated Distribution System.
Decision Period	In respect of a Force Majeure Event Claim, the period within which the ERC must give a notice to the relevant Affected Regulated Entity under Section 10.3.1 to avoid a deemed notification of its decision under Section 10.3.2 (see Section 10.3.3).
Distribution Connection Assets	In respect of a Regulated Distribution System, the components of that Regulated Distribution System which are used to provide Distribution Connection Services in respect of that Regulated

	Distribution System.
Distribution Connection Point	In respect of a Regulated Distribution System, the point of connection of a User System or Equipment to the Regulated Distribution System, excluding Grid Connection Points.
Distribution Connection Services	<p>In respect of a Regulated Distribution System:</p> <ul style="list-style-type: none">(a) the provision of capability at a Distribution Connection Point in respect of that Regulated Distribution System to deliver electricity to or take electricity from that Distribution Connection Point;(b) the conveyance of electricity:<ul style="list-style-type: none">(i) to a Distribution Connection Point in respect of that Regulated Distribution System from any User System or Equipment which is directly connected to that Regulated Distribution System at that Distribution Connection Point; or(ii) from a Distribution Connection Point in respect of that Regulated Distribution System to any User System or Equipment which is directly connected to that Regulated Distribution System at that Distribution Connection Point; or(iii) from an embedded generator to a Regulated Distribution System, also where the generation plant is installed outside the franchise area of the Regulated Entity operating the Regulated Distribution System.(c) the planning, installation, maintenance, augmentation, testing and operation of Distribution Connection Assets in respect of that Regulated Distribution System; and(d) the provision of services that support any of the services referred to in paragraphs (a) to (c).
Distribution System	In respect of a Regulated Entity, a system of wires and associated facilities extending between the delivery points on the Grid and any Subtransmission System operated by a person other than a Regulated Entity, on the one hand, and the points of connection of User Systems and Equipment of End-users, on the other hand.
Distribution Services and Open Access Rules (DSOAR)	Distribution Services and Open Access Rules, as promulgated by the ERC under Resolution No. 1, Series of 2006, dated January 18, 2006.
Distribution Utility	An electric cooperative, private corporation, government-owned utility, or existing local government unit, that has an exclusive franchise to operate a Distribution System in accordance with the EPIRA.

Rules for Setting Distribution Wheeling Rates
First Entry Group : 3rd Regulatory Period

Effectivity Date	The date on which these Rules take effect.
Eligible Force Majeure Pass Through Amount	<p>At any time in respect of a Force Majeure Event, the increase in costs that the relevant Affected Regulated Entity has actually incurred at that time (as calculated by the Affected Regulated Entity under Section 10.1.2 or determined by the ERC under Section 10.3.1, as appropriate):</p> <ul style="list-style-type: none">(a) in the distribution of electricity to Distribution Connection Points in respect of the relevant Regulated Distribution System; and(b) in complying with the provisions of any legislation, or of any rules, regulations or guidelines made under the EPIRA, including the IRR and the Distribution Code, which must be complied with in relation to the distribution of such electricity, <p>as a result of the occurrence of that Force Majeure Event.</p>
Eligible Tax Pass Through Amount	<p>In respect of a Tax Change Event, the increase in costs in the distribution of electricity to Distribution Connection Points in respect of the relevant Regulated Distribution System that the relevant Affected Regulated Entity has incurred and is likely to incur, until the end of the Regulatory Period in which the Tax Change Event occurs, as a result of that Tax Change Event (as calculated by the Affected Regulated Entity under Section 11.2.1(c) or determined by the ERC under Section 11.2.2(a), as appropriate).</p>
Entry Group	<p>A group of Regulated Entities entering the performance-based regulation program at the same Entry Point. There are four Entry Groups, as described in Appendix E.</p>
Entry Point	<p>The date at which an Entry Group become subject to performance-based regulation. There are four Entry Points into this program, as described in Appendix E.</p>
EPIRA	<p>Republic Act No. 9136, otherwise known as the Electric Power Industry Reform Act of 2001.</p>
Equipment	<p>All apparatus, machines, conductors, etc. used as a part of, or in connection with, an electrical installation, as defined in the Distribution Code.</p>
ERC	<p>The Energy Regulatory Commission created by Section 38 of the EPIRA.</p>

Rules for Setting Distribution Wheeling Rates
First Entry Group : 3rd Regulatory Period

Excluded Service	A service that is provided in a Qualified Franchise Area in the ordinary course of an electricity distribution business that is conducted in that area, being a service that is neither a Regulated Distribution Service in respect of a Regulated Distribution System nor a service that is contestable (for these purposes, whether or not a service is contestable is a matter that, if disputed, will be determined by the ERC).
Force Majeure Pass Through Amount	An amount that is not greater than an Eligible Force Majeure Pass Through Amount as referred to in Section 10.1.2.
Force Majeure Threshold Amount	In respect of a Regulatory Year, the amount calculated in accordance with Section 10.2.
Force Majeure Event	(a) A typhoon, storm, tropical depression, flood, drought, volcanic eruption, earthquake, tidal wave or landslide; or (b) an act of public enemy, war (declared or undeclared), sabotage, blockade, revolution, riot, insurrection, civil commotion or any violent or threatening actions, which results or is likely to result in an increase in the costs incurred by a Regulated Entity in the distribution of electricity to Distribution Connection Points in respect of a Regulated Distribution System that is operated by it, or in complying with the provisions of any legislation, or of any rules, regulations or guidelines made under the EPIRA, including the IRR and the Distribution Code, which must be complied with in relation to the distribution of such electricity.
Force Majeure Event Claim	A written claim that satisfies the requirements set out in Section 10.2.3.
Force Majeure Event Notice	A written notice that satisfies the requirements set out in Section 10.2.2.
Forecast Period	A twelve month period ending on December 31 in an Application Year (see Section 6.3.3(a)).
Grid Connection Point	A "Connection Point" is the point of connection of a user system or equipment to the grid, as defined in the Transmission Wheeling Rate Guidelines.
Historical Period	A twelve month period ending on December 31 (see Section 6.2.1(a)).
IRR	The Implementing Rules and Regulations issued pursuant to the EPIRA.
Issues Paper	The Regulatory Reset Issues Paper published by the ERC to invite consultation on the ERC's views on the issues pertinent to the Regulatory Reset Process for the Third Regulatory Period.
Last Resort	Any of the following situations where a contestable customer is

Rules for Setting Distribution Wheeling Rates
First Entry Group : 3rd Regulatory Period

Supply Event	served by the Supplier of Last Resort: <ul style="list-style-type: none">(a) the customer's Retail Energy Supplier has ceased to operate;(b) the license of the customer's Retail Energy Supplier has been revoked or not renewed by ERC;(c) the arrangements for distribution wheeling service between the customer's Retail Energy Supplier and the distribution utility have been terminated;(d) the customer's Retail Energy Supplier is no longer permitted to trade electric energy through the wholesale electricity spot market (WESM), if a WESM member; or(e) the customer fails to exercise its option to choose its supplier of electricity upon the implementation of retail competition and open access.
Local Government	Local Government as defined in Executive Order No. 292, otherwise known as the Administrative Code of 1987.
Major Project	A capital expenditure project: <ul style="list-style-type: none">(a) which is contained in the capital expenditure program that is approved by the ERC under Section 4.12.5 for a Regulated Distribution System; and(b) for which the capital expenditure forecasted in any Regulatory Year for that project (as contained in that program) is greater than PhP30 million or 20% of the total capital expenditure forecasted for that Regulatory Year under that program, whichever is lower.
Negative Tax Change Event	A Tax Change Event which results in a Regulated Entity incurring materially lower costs than it would have incurred but for that event in the distribution of electricity to Distribution Connection Points in respect of a Regulated Distribution System that is operated by it.
Negative Tax Pass Through Amount	An amount that is not greater than a Required Tax Pass Through Amount as referred to in Section 11.1.2.
Non-system Assets	Those assets forming part of the Regulatory Asset Base that are required to provide Regulated Distribution Services, but are not Distribution System assets or Distribution Connection Assets.
person	Refers to a natural or juridical person, as the case may be.
PhP	Philippine Peso.

Rules for Setting Distribution Wheeling Rates
First Entry Group : 3rd Regulatory Period

Position Paper	The regulatory document which will be prepared following consultation on the Issues Paper, to state the ERC's final position on the Regulatory Reset Process for the next Regulatory Period.
Positive Tax Change Event	A Tax Change Event which results in a Regulated Entity incurring materially higher costs than it would have incurred but for that event in the distribution of electricity to Distribution Connection Points in respect of a Regulated Distribution System that is operated by it.
Positive Tax Pass Through Amount	An amount that is not greater than an Eligible Tax Pass Through Amount as referred to in Section 11.1.1.
Qualified Franchise Area	A Franchise Area that is included in Appendix A, as such area may be varied from time to time in accordance with the law.
Quarter	A period of three months from January 1 to March 31 (both dates inclusive), April 1 to June 30 (both dates inclusive), July 1 to September 30 (both dates inclusive) or October 1 to December 31 (both dates inclusive).
Regulated Distribution Services	<p>In respect of a Regulated Distribution System:</p> <ul style="list-style-type: none">(a) the conveyance of electricity through the Regulated Distribution System and the control and monitoring of electricity as it is conveyed through the Regulated Distribution System (including any services that support such conveyance, control or monitoring or the safe operation of the Regulated Distribution System);(b) the planning, maintenance, augmentation and operation of the Regulated Distribution System;(c) the provision, installation, commissioning, testing, repair, maintenance and reading both of meters that are used to measure the delivery of electricity to persons whose User Systems or Equipment is directly connected to the Regulated Distribution System and of other meters that are used (for the purposes of the Wholesale Electricity Spot Market) to measure the flow of electricity into or through the Regulated Distribution System;(d) Distribution Connection Services in respect of the Regulated Distribution System except to the extent that such Distribution Connection Services have been determined by the ERC to be Excluded Services (in which case, for the purposes of these Rules, such Distribution Connection Services will be deemed not to be Regulated Distribution Services in respect of that Regulated Distribution System with effect from the commencement of the Regulatory Period first occurring after the making of that

determination);

- (e) the provision of Ancillary Services that are provided using assets which form part of the Regulated Distribution System¹ (excluding any such Ancillary Services to the extent they are provided to the System Operator under contract, or through a spot market established under the WESM Rules); and
- (f) billing, collection and customer services that are directly related to the delivery of electricity through the Regulated Distribution System to Distribution Connection Points in respect of the Regulated Distribution System and billing, collection and customer services for persons purchasing or receiving (or seeking to purchase or receive) any Distribution Connection Services in respect of the Regulated Distribution System,

but do not include such of these services as are determined by the ERC to be contestable.

Note: These Rules do not extend to inset networks, i.e. networks operated by third parties that are connected to a distribution system and that serve, for example, free port areas (see the definition of Distribution Connection Point).

Regulated Distribution System

A Distribution System which is located in a Qualified Franchise Area and that is operated under an exclusive franchise, together with such Subtransmission Systems as are connected to that Distribution System and as are operated only by the Regulated Entity that operates that Distribution System.

Regulated Entity

Collectively, any entity or entities who provide any Regulated Distribution Services in respect of a Regulated Distribution System, but excluding such persons as the ERC from time to time determines (such exclusion may identify the relevant persons specifically or by description and may be made subject to such conditions as the ERC considers appropriate). The entity or entities that comprise Regulated Entities for the purposes of these Rules and their respective Qualified Franchise Areas are such entities as are included in Appendix A.

Regulated Retail Services

The distribution business segment defined in the Business Separation Guidelines that relates to the provision of Retail Services pertaining to the sale of electricity to end-users who are included in the Captive Market.

¹ An example of such Ancillary Services is services provided by a series reactor or a static VAR compensator.

Rules for Setting Distribution Wheeling Rates
First Entry Group : 3rd Regulatory Period

Regulatory Asset Base	Those assets employed by a Regulated Entity to provide efficient Regulated Distribution Services. It covers the Regulated Distribution System assets as well as the Non-system Assets required to support the delivery of Regulated Distribution Services.
Regulatory Depreciation	The depreciation calculated in respect of the Regulatory Asset Base as described in Section 4.10, being one of the building blocks which forms the basis for calculating the annual revenue requirement for a Regulated Distribution System.
Regulatory Period	The First Regulatory Period, the Second Regulatory Period or a Subsequent Regulatory Period (as the case may be).
Regulatory Reset Expert	An expert referred to in Section 14.1.1.
Regulatory Reset Process	The regulatory reset process before the start of the Third Regulatory Period or subsequent regulatory periods. A regulatory reset process refers to the actions prior to the start of any Regulatory Period, through which the price control arrangements are established that will apply to a Regulated Entity with regard to the provision of Regulated Distribution Services in each Regulated Distribution System for the next Regulatory Period. This process relies on submissions by Regulated Entities, decisions by the ERC and consultation with the Regulated Entities and the public in general, as described in the RDWR.
Regulatory Year	Any 12 month period that commences on July 1 and ends on the following June 30 (both dates inclusive) and that occurs during a Regulatory Period.
Regulatory WACC	The weighted average cost of capital established for the purposes of the performance based regulation of Regulated Entities in accordance with section 4.11.
Relevant Tax	Any Tax payable by a Regulated Entity other than: <ul style="list-style-type: none">(a) corporate income tax or other income tax; or(b) any tax on fringe benefits or capital gains; or(c) any franchise tax or donor's tax; or(d) penalties, charges, fees and interest on late payments, or deficiencies in payments, relating to any Tax, unless these arise as a result of a challenge by a Regulated Entity to the imposition of any Tax, where the ERC is advised of such a challenge in advance and provided with pertinent supporting documents in advance deems the challenge to be based on reasonable and appropriate grounds; or(e) any Tax that replaces or is the equivalent of any of the Taxes referred to in paragraphs (a) to (d); or

Rules for Setting Distribution Wheeling Rates
First Entry Group : 3rd Regulatory Period

- (f) any franchise fee, or other amount payable under an instrument granting a franchise, in relation to the operation of a Regulated Distribution System.

**Required Tax
Pass Through
Amount**

In respect of a Tax Change Event, the costs in the distribution of electricity to Distribution Connection Points in respect of the relevant Regulated Distribution System that the relevant Affected Regulated Entity has saved and is likely to save, until the end of the Regulatory Period in which the Tax Change Event occurs, as a result of that Tax Change Event (as determined by the ERC under Section 11.1.2).

Retail Services

Services provided to end-users pertaining to the sale of electricity, which includes:

- (a) billing, collection, customer service, energy trading and electricity sales; and
- (b) provision, installation, commissioning, testing, repair, maintenance and reading of meters that are used to measure the delivery of electricity to customers;

but excludes the cost of generation or actual energy consumed.

Rules for Setting Distribution Wheeling Rates
First Entry Group : 3rd Regulatory Period

Re-valuation	In relation to a Regulated Distribution System, the asset re-valuation that is referred to in Section 4.8.1.
Re-valuation Date	A date determined by the ERC during the Regulatory Reset Process for which the Re-valuation is prepared. This date will be no later than 15 months prior to the start of the Regulatory Period for which a Re-valuation is being conducted.
Re-valuation Report	A report prepared to reflect the value of the Regulatory Asset Base at the Re-valuation Date, as referred to in Section 4.8.2(c) or (d) (as the case may be).
Revenue Potential	<p>In respect of any Transferred Subtransmission Assets, the consideration for the transfer of those Transferred Subtransmission Assets from National Transmission Corporation (TRANSCO) or the National Grid Company of the Philippines (NGCP) to the Regulated Entity, which consideration is required (by Section 8 of the EPIRA and Rule 22, Section 13(b) of the IRR) to be:</p> <ul style="list-style-type: none">(a) determined by TRANSCO or NGCP based on the revenue potential of those Transferred Subtransmission Assets; or(b) in case of disagreement, determined by, or in accordance with directions given by, the ERC.
Rolled-forward Depreciated Regulatory Asset Base	The regulatory asset base for a Regulated Distribution System as determined by the ERC under Section 4.8.12 or as calculated in accordance with Section 4.9.2 (see also Section 4.9.1) (as the case may be).
Rules of Practice and Procedure	A regulatory guideline published by the ERC that guides participation in the ERC's proceedings, including the proceedings described in these Rules for Setting Distribution Wheeling Rates.
Second Regulatory Period	The period set out in Section 2.2.
Subsequent Regulatory Period	A Regulatory Period other than and following the Second Regulatory Period, the duration of which is set out in Section 2.4.
Supplier of Last Resort	A Regulated Entity designated by the ERC to serve end-users in the contestable market following a Last Resort Supply Event.
System Operator	The party identified as the System Operator pursuant to the Grid code which is the party responsible for generation dispatch; the provision of ancillary Services, and operation and control to ensure safety, power quality, stability, reliability and the security of the grid.
Tax	Any tax, levy, impost, deduction, charge, rate, duty or withholding which is levied or imposed by the National

	<p>Government or a Local Government or any agency, department, instrumentality or other authority of the National Government or a Local Government.</p>
Tax Change Event	<p>(a) A change in (or a change in the application or official interpretation of) a Relevant Tax or the way in which a Relevant Tax is calculated; or</p> <p>(b) the removal of a Relevant Tax; or</p> <p>(c) the imposition of a Relevant Tax,</p> <p>which results in a Regulated Entity incurring materially higher or lower costs than it would have incurred but for that event in the distribution of electricity to Distribution Connection Points in respect of a Regulated Distribution System that is operated by it. For these purposes, a Regulated Entity will only be deemed to incur materially higher or lower costs where the change in the relevant costs that the Regulated Entity has incurred and is likely to incur until the end of that Regulatory Period, as a result of that Tax Change Event (or combination of tax change events), exceeds 1% of the total forecast operating and maintenance expenditure in relation to the relevant Regulated Distribution System (expressed in nominal terms and excluding forecast taxes, levies and duties) as is used for the purposes of the Regulatory Reset Process under Article VII for that Regulatory Period and as pertains to the period from the occurrence of that Tax Change Event to the end of that Regulatory Period.</p> <p>The costs associated with any reasonable steps taken by a Regulated Entity to challenge the imposition or change of a Relevant Tax, in order to protect its customers from the rate-impact of such an event, will be deemed to be included as part of the cost associated with a Tax Change Event.</p>
Third Regulatory Period	<p>The Regulatory Period which immediately follows the Second Regulatory Period, described in section 2.3.</p>
Transferred Subtransmission Assets	<p>Subtransmission Assets that are transferred from the National Transmission Corporation (TransCo) or the National Grid Corporation of the Philippines (NGCP) to the Regulated Entity as contemplated by Section 8 of the EPIRA and Rule 22, Section 13(b) of the IRR.</p>
Transition Regulatory Period	<p>In respect of Distribution Connection Services that the ERC has determined to be Excluded Services, the Regulatory Period first occurring after that determination is made (see Section 1.6.5).</p>
Transmission Wheeling Rate Guidelines	<p>The Guidelines on the Methodology for Setting Transmission Wheeling Rates for 2003 to around 2027 promulgated by the ERC under Section 43(f) of the EPIRA and Rule 15, Section 5(a) of the IRR, subsequently amended as the Rules for setting</p>

	Transmission Wheeling Rates (RTWR).
Uniform Rate Filing Requirements	The Uniform Rate Filing Requirements dated January 13, 2001 resulting from ERC Case No. 2001-873 docketed on October 31, 2001.
User System	A system owned or operated by a user of the grid or distribution system, as defined in the Distribution Code.
Valuation Handbook	A set of guidelines prepared by the ERC in terms of which the replacement cost valuation for the Regulatory Asset Base of Regulated Entities will be conducted for the Third Regulatory Period, as described in Section 4.8.7.

In addition, words and phrases used in these Rules which are defined in the EPIRA or the IRR have the meaning given to them in the EPIRA or the IRR (as the case may be).

1.4 Interpretation

1.4.1 In these Rules, unless the contrary intention appears:

- (a) the singular includes the plural and conversely;
- (b) where a term is defined, its other grammatical forms have a corresponding meaning;
- (c) a reference to any law or the rules and regulations issued implementing such a law or to any particular provision of a law or of any rules or regulations issued implementing such a law is taken to include any modification, consolidation, amendment, re-enactment, replacement or codification of the law, rules and regulations, or provision;
- (d) mentioning anything after include, includes or including does not limit what else might be included; and
- (e) a reference to any period includes both the day on which that period commences and the day on which it expires.

1.4.2 All calculations made under or for the purposes of these Rules must be rounded to four significant digits, except that any amount which is calculated solely in PhP (as opposed to, for example, PhP/kWh) must be rounded to the nearest peso. For these purposes, significant digits are all the non-zero digits of a number and the zeros that are included between them or that are final zeros and signify accuracy (e.g. the significant digits of 0.01230 are 1, 2, 3 and the final 0, which signifies accuracy to five places).²

1.4.3 A reference in these Rules to Regulatory Year "t" or year "t" is a reference to the 12 month period ending on June 30 in calendar year t (e.g. a reference to Regulatory Year 2013 or to year 2013 is a reference to the 12 month period ending on June 30, 2013).

1.4.4 When a calculation is required under these Rules:

² Webster's College Dictionary, Random House, New York, 1991.

- (a) Regulatory Year “t” or year “t” is the Regulatory Year or 12 month period ending on June 30 in respect of which the calculation is being made;
- (b) Regulatory Year “t-1” or year “t-1” is the Regulatory Year or 12 month period ending on June 30 immediately preceding Regulatory Year “t” or year “t”;
- (c) Regulatory Year “t-2” or year “t-2” is the Regulatory Year or 12 month period ending on June 30 immediately preceding Regulatory Year “t-1” or year “t-1”;
and
- (d) Regulatory Year “t-3” or year “t-3” is the Regulatory Year or 12 month period ending on June 30 immediately preceding Regulatory Year “t-2” or year “t-2”.

1.5 Rights and Obligations of Regulated Entity

- 1.5.1 Where more than one entity provides any Regulated Distribution Services in respect of a Regulated Distribution System, with the result that the relevant Regulated Entity comprises more than one entity, the rights of that Regulated Entity under these Rules may be exercised by any of those entities and such exercise of those rights by such an entity will be deemed, for the purposes of these Rules, to irrevocably and unconditionally bind each of those entities.
- 1.5.2 Where more than one entity provides any Regulated Distribution Services in respect of a Regulated Distribution System, with the result that the relevant Regulated Entity comprises more than one entity, each of those entities will be jointly and severally liable for the performance of the obligations of the relevant Regulated Entity under these Rules and the performance of such obligations by any of those entities will be deemed, for the purposes of these Rules, to be the performance of those obligations by each of those entities.
- 1.5.3 Where more than one entity provides any Regulated Distribution Services in respect of a Regulated Distribution System, with the result that the relevant Regulated Entity comprises more than one entity, the performance by the ERC of its obligations under these Rules in respect of any one of those entities will be deemed, for the purposes of these Rules, to be the performance of those obligations in respect of all of those entities.
- 1.5.4 Where more than one entity provides any Regulated Distribution Services in respect of a Regulated Distribution System, with the result that the relevant Regulated Entity comprises more than one entity, these Rules must be construed and applied in such a manner that, as far as is reasonably practicable, results in all of those entities being treated (in the aggregate) in the same manner as a single entity would have been treated in those circumstances if that single entity alone had comprised that Regulated Entity.
- 1.5.5 It is acknowledged that a range of ownership, operating, corporate and other structures may be implemented in relation to the provision of Regulated Distribution Services in respect of a Regulated Distribution System. Accordingly, these Rules must be construed and applied by the ERC in such a manner that accommodates such structures but that does not permit the use of such structures to avoid the tenor of the obligations imposed by these Rules (even if this means a departure from a literal interpretation of these Rules).

1.6 Services other than Regulated Distribution Services

- 1.6.1 This Section 1.6 only applies to Excluded Services that are provided on or after July 1, 2011.
- 1.6.2 Except as otherwise provided in the DSOAR, a person may only be charged a fair and reasonable charge for an Excluded Service.
- 1.6.3 In the event of a dispute in respect of the amount of a charge for an Excluded Service, what is a fair and reasonable charge will be determined by the ERC.
- 1.6.4 For the purposes of determining what is a fair and reasonable charge for an Excluded Service, both where a charge for an Excluded Service is being negotiated and where a dispute in respect of such a charge is being determined by the ERC, the following matters must be taken into account (without limitation to any other matters that may be taken into account for those purposes):
- (a) the reasonable costs incurred in efficiently providing the Excluded Service, including:
 - an allowance for appropriately attributable operating and maintenance and overhead costs;
 - an allowance for the depreciation of the assets used to provide the Excluded Service over the economic life of those assets;
 - a reasonable return on the depreciated value of the assets used to provide the Excluded Service (such reasonable return might, for example, be an appropriate weighted average cost of capital as calculated pursuant to Section 4.11 or Section 5.8); and
 - an allowance for taxes paid in connection with the provision of the Excluded Service or the income derived from the provision of the Excluded Service;
 - (b) the charge that would have been likely to be negotiated for the provision of the Excluded Service in an arm's length commercial negotiation between a willing seller and a willing buyer if the market for the Excluded Service were competitive;
 - (c) whether any assets used to provide the Excluded Service to the person purchasing or receiving (or seeking to purchase or receive) the Excluded Service will be or have been specifically constructed for that purpose;
 - (d) any special value of the Excluded Service to the person purchasing or receiving (or seeking to purchase or receive) the Excluded Service (for example, as a result of any assets used to provide the Excluded Service being dedicated to the provision of that Excluded Service to that person); and
 - (e) whether any costs incurred in providing the Excluded Service (including any return on assets used to provide the Excluded Service) have been or are likely to be recovered from other persons (for example, as a result of any assets used to provide the Excluded Service subsequently being used to provide that Excluded Service to such other persons).

1.6.5 Without in any way limiting the services that may constitute an Excluded Service, any Distribution Connection Services in respect of a Regulated Distribution System which may have been determined by the ERC to be Excluded Services will, with effect from the commencement of the Regulatory Period first occurring after the making of that determination (the **Transition Regulatory Period**), be treated as Excluded Services (except to the extent they are determined by the ERC to be contestable). For the purposes of determining what is a fair and reasonable charge for such Distribution Connection Services, both where a charge for such Distribution Connection Services is being negotiated and where a dispute in respect of such a charge is being determined by the ERC (and without limiting any other matters that may be taken into account for those purposes):

- (a) the matters referred to in Section 1.6.4 must be taken into account; and
- (b) to the extent any assets used to provide such Distribution Connection Services as at the commencement of the Transition Regulatory Period were, immediately prior to the commencement of the Transition Regulatory Period, included in the regulatory asset base for the relevant Regulated Distribution System (see Section 4.8.8), those assets will be valued at the value that was then attributed to them as part of that regulatory asset base (to the extent such assets are used to provide Distribution Connection Services in respect of the relevant Regulated Distribution System after the commencement of the Transition Regulatory Period, those assets will cease to form part of the regulatory asset base for that Regulated Distribution System: see Section 4.8.8(a)).

1.7 Subtransmission Assets

1.7.1 Each Regulated Entity must maintain an asset register which clearly identifies each asset owned by it that is a Subtransmission Asset and which separately identifies those assets which are Transferred Subtransmission Assets.

1.8 Provision of Information

1.8.1 A Regulated Entity must, on the written request of the ERC or as specified in these Rules, provide the ERC with such information, calculations, forecasts and other data as the ERC requires from time to time for the purposes of these Rules and for the purposes of assisting the ERC to perform its functions under these Rules. All information submissions are to be made in accordance with the terms of the ERC's Rules of Practice and Procedure.

1.8.2 By default, all information requested by the ERC has to be provided within ten (10) working days from such a request being formally issued to a Regulated Entity. However, in exceptional circumstances the ERC may require information to be submitted in a shorter timeframe, which will be pre-agreed with the Regulated Entity involved. For information submissions that is likely to involve more time to prepare than that allowed by the default period, the ERC may grant an extension of time. Such an extension of time may also be requested by a Regulated Entity, in writing to the ERC. The ERC will consider such requests and within three working days of receiving a request advise the Regulated Entity of its approval (which will not be unreasonably withheld), or otherwise.

1.9 Amendment

1.9.1 Subject to Sections 1.9.2 and 1.9.3, these Rules may from time to time be amended by the ERC:

- (a) in respect of their application in relation to all Regulated Entities and all Regulated Distribution Systems; or
- (b) in respect of their application in relation to particular Regulated Entities and particular Regulated Distribution Systems,
but only if such amendments are:
- (c) for the purposes of giving effect to a decision made by the ERC in accordance with these Rules; or
- (d) made with the agreement of the affected Regulated Entity or Regulated Entities; or
- (e) required pursuant to an order that is made by a court with appropriate jurisdiction.

1.9.2 The ERC may amend Appendix A to remove a Qualified Franchise Area (with the result that the charges that may be made for the provision of services in respect of the relevant Distribution System that is located in that Qualified Franchise Area, or in respect of any Subtransmission System that is connected to it and that is operated only by the Regulated Entity that operates the Distribution System, cease to be regulated under these Rules) where:

- (a) the charges that may be made for the provision of services in respect of that Distribution System, and in respect of any Subtransmission System that is connected to it and that is operated only by the Regulated Entity that operates the Distribution System, become regulated under other guidelines promulgated for that purpose by the ERC pursuant to Section 43(f) of the EPIRA and Rule 15, Section 5(a) of the IRR; and
- (b) the Regulated Entity that operates that Distribution System agrees to that amendment.

Such an amendment may be made, for example, where the Regulated Entity and the ERC agree that the form of price control that is to apply in respect of such charges is to be a hybrid cap.

1.9.3 The ERC may amend these Rules so that they apply to regulate the charges that may be made for the provision of services in respect of a Subtransmission System that is operated by more than one Distribution Utility where:

- (a) at least one of those Distribution Utilities is a Regulated Entity and operates a Regulated Distribution System that is connected to that Subtransmission System;
- (b) such of those Distribution Utilities as are Regulated Entities agree to those amendments;
- (c) those amendments are necessary to enable these Rules to apply to those charges in substantially the same way as they apply to the charges that may be made for the provision of Regulated Distribution Services in respect of a Regulated Distribution System; and

(d) those amendments would not have a materially adverse effect on the rights or obligations of any other Regulated Entity under these Rules (if such amendments would have that effect, they must not be made without the agreement of all the Regulated Entities).

1.9.4 Nothing in these Rules is to be construed as precluding the ERC from promulgating other guidelines pursuant to Section 43(f) of the EPIRA and Rule 15, Section 5(a) of the IRR for the purpose of regulating the charges that may be made for the provision of services in respect of Distribution Systems and Subtransmission Systems that are not subject to these Rules.

1.10 Separability

1.10.1 If, for any reason, any provision or part of a provision of these Rules is declared unconstitutional or invalid, those provisions which are not thereby affected will continue to be in full force and effect.

1.11 Effectivity

1.11.1 These Rules take effect 15 days following their publication in a newspaper of general circulation.

**ARTICLE II
TIMING FOR REGULATORY PERIODS**

2.1 Steps to Incentive Based Rate Regulation

- 2.1.1 Subject to Articles VIII, X, XI and XII, the Maximum Annual Price cap for a Regulated Distribution System (MAP,) as calculated in accordance with the formula set out in Section 4.2.1 will apply to regulate the maximum average price that a Regulated Entity is permitted to charge for the provision by it, during the Third Regulatory Period, of Regulated Distribution Services in respect of that Regulated Distribution System.
- 2.1.2 Subject to Articles V, X and XI, the price cap that is calculated in a manner determined by the ERC in accordance with the provisions of Article V will apply to regulate the maximum average price that a Regulated Entity is permitted to charge for the provision by it, during a Subsequent Regulatory Period, of Regulated Distribution Services in respect of a Regulated Distribution System.

2.2 Second Regulatory Period

- 2.2.1 The Second Regulatory Period for the First Entry Group commenced on July 1, 2007 and ends on June 30, 2011 (both dates inclusive).

2.3 Third Regulatory Period

- 2.3.1 The Third Regulatory Period will commence on July 1, 2011 and end on June 30, 2015 (both dates inclusive).

2.4 Subsequent Regulatory Periods

- 2.4.1 Each Subsequent Regulatory Period will:
- (a) commence on the day that immediately follows the day on which the immediately preceding Regulatory Period ends; and
 - (b) end on the fourth anniversary of the day on which the immediately preceding Regulatory Period ends,
 - (c) both dates inclusive.

ARTICLE III
PREVIOUS REGULATORY PERIODS

3.1 General Principle

- 3.1.1 All Regulated Entities in the First Entry Point into the Third Regulatory Period has been subject to Performance Based Regulation during the Second Regulatory Period.
- 3.1.2 Amounts earned during the Second Regulatory Period in terms of the Maximum Annual Price Cap (MAP) determined by the ERC under these Rules, as well as any amounts over- or under-recovered by a Regulated Entity during the Second Regulatory Period form inputs into the calculation of the MAP for the Third Regulatory Period. This includes the recovery of amounts disallowed by the ERC as a regulatory intervention during the Second Regulatory Period. The mechanism by which these amounts are accounted for is described in Section 4.
- 3.1.3 Service and quality performance levels achieved by a Regulated Entity during the Second Regulatory Period will be considered under the performance incentive scheme (PIS) for the Third Regulatory Period. These historical performance levels will be used both in setting performance targets for the Third Regulatory Period (described in Section 4.15.4), and also in determining the S-factor that will apply during year 1 of the Third or Subsequent Regulatory Years (as per Section 4.2.1).

ARTICLE IV
THIRD REGULATORY PERIOD

4.1 General Price Control Principles

- 4.1.1 Subject to Section 6.2.1(f) and (g), the maximum distribution wheeling rates that a Regulated Entity is permitted to charge for the provision by it, during each Regulatory Year that occurs in the Third Regulatory Period, of Regulated Distribution Services in respect of a Regulated Distribution System will be set under a Maximum Annual Price cap for that Regulated Distribution System that is determined in accordance with this Article IV and the Regulatory Reset Process for the Third Regulatory Period under Article VII.
- 4.1.2 A Regulated Entity must ensure that the maximum average price that it charges for the provision by it, during a Regulatory Year t that occurs in the Third Regulatory Period, of Regulated Distribution Services in respect of a Regulated Distribution System does not exceed the Maximum Annual Price cap for that Regulated Distribution System for Regulatory Year t as calculated in accordance with Section 4.2.1. Notwithstanding the foregoing, a failure to comply with this obligation will not be a violation of these Rules. (Any revenue that is derived as a result of that Maximum Annual Price cap being exceeded will effectively be returned to Customers of that Regulated Distribution System by way of a reduction in the Maximum Annual Price cap for that Regulated Distribution System for the following Regulatory Year $t+1$ to an amount that is lower than that which would otherwise have applied. This correction is carried over between Regulatory Periods as well.)³

4.2 Price Control Formula

- 4.2.1 Subject to Articles VIII, X, XI and XII, the maximum average price (expressed in PhP/kWh) that a Regulated Entity is permitted to charge for the provision by it, during a Regulatory Year t that occurs in the Third Regulatory Period, of Regulated Distribution Services in respect of a Regulated Distribution System (the Maximum Annual Price cap for that Regulated Distribution System for Regulatory Year t or MAP_t) is calculated in accordance with the following formula:

- (a) Where Regulatory Year t is Regulatory Year 2012,

$$MAP_{2012} = SMAP_{2012} + S_t - K_t + ITA_t \quad ; \text{ and}$$

- (b) Where Regulatory Year t is a Regulatory Year (other than the first Regulatory Year) in the Third Regulatory Period,

$$MAP_t = [MAP_{t-1} \times \{1 + CWI_t - X\}] + S_t - K_t + ITA_t$$

Where:

$SMAP_{2012}$ is as calculated under Section 4.15.4;

CWI_t = Change in Weighted Index for Regulatory Year t as calculated in accordance with Section 4.5;

³ No monthly determination of tariffs by the ERC is required under these Guidelines.

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- X = An Efficiency Factor in respect of that Regulated Distribution System for Regulatory Year t. X equals the value calculated by the ERC for the Third Regulatory Period under Section 4.15.3, or recalculated (and, if applicable, increased) under Sections 12.2.2 or 12.4.6 (as the case may be) (subject to any recalculation under Sections 12.2.2 or 12.4.6, it is constant for the whole of the Third Regulatory Period). For the avoidance of doubt, X may be a positive or negative value or may be zero;
- S_t = A performance incentive factor calculated in accordance with Section 4.18.2 to reward each Regulated Entity for achieving specified target levels of performance and penalize each Regulated Entity for failing to achieve specified target levels of performance during the twelve-month period ending on December 31 of Regulatory Year t-1). For the avoidance of doubt, S_t may be a positive or negative value or may be zero;
- K_t = Correction Factor to adjust for over or under recovery of revenue in Regulatory Year t-1. K_t is calculated in accordance with Sections 4.3.1 and 4.3.2; and
- ITA_t = Tax Adjustment to adjust for over or under recovery of corporate income tax in Regulatory Year t-1. Where Regulatory Year t is any Regulatory Year in the Third Regulatory Period, ITA_t equals 0 (zero). Where Regulatory Year t is a Regulatory Year in a later Regulatory Period, ITA_t is calculated in accordance with Section 4.4.

4.2.2 All the provisions in this Article IV apply for the Third Regulatory Period only, except to the extent Article V specifically carries forward all or a part of those provisions for the purposes of their application in a Subsequent Regulatory Period.

4.3 Over / Under Recovery Formula

4.3.1 Except as otherwise provided in Section 4.2.1, the Correction Factor for Regulatory Year t (K_t), where Regulatory Year t is a Regulatory Year that occurs in the Third Regulatory Period, is calculated in accordance with Section 4.3.2. For the purposes of this Section 4.3:

- (a) The actual weighted average tariff (expressed in PhP/kWh) for Regulatory Year t ($AWAT_t$) is calculated as follows:

$$AWAT_t = \frac{CR_{t-1} + RBR_{t-1} + AISDA_{t-1} - FISDA_{t-1}}{CQ_{t-1}}$$

Where:

- CR_{t-1} = The amount (expressed in PhP) billed to Customers of the relevant Regulated Distribution System for the provision of Regulated Distribution Services by the Regulated Entity that operates that Regulated Distribution System, during the 12 month period ending on December 31 in Regulatory Year t-1, the amount:

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- so billed being determined in a manner that is approved for this purpose by the ERC and adjusted to:
 - (A) exclude any amounts by which the Regulated Entity's revenue is increased due to the application of Articles X or XI and any surcharges of the kind referred to in Section 8.2.2(b);
 - (B) include any amounts by which that revenue is decreased due to the application of Article XI or the payment of any rebates of the kind referred to in Section 8.2.2(b);
 - (C) reflect the impact of re-opening or adjustment events due to the application of Article XII; and
- as so determined and adjusted being audited to the satisfaction of the ERC by a person that is approved for this purpose by the ERC;

RBR_{t-1} = Such portion (expressed in PhP) of the net income derived, during the 12 month period ending on December 31 in Regulatory Year t-1, from each related business undertaking, examples of which are provided in Section 4.3.4, which is engaged in directly or indirectly by the Regulated Entity that operates the relevant Regulated Distribution System and which utilizes assets that form part of the regulatory asset base for that Regulated Distribution System (see Section 4.8.8), being a portion that is determined by the ERC pursuant to Section 26 of the EPIRA and that may vary as between such business undertakings but which, for each such business undertaking, will be set at 50% of the net income that is so derived from that business undertaking;

AISDA_{t-1} = The actual income (expressed in PhP) derived by a Regulated Entity from the sale of disposed assets that were previously part of the rolled forward regulatory asset base for a Regulated Distribution System during the 12 month period ending on December 31 in Regulatory Year t-1, after deducting any expenses associated with the sale but excluding the value at which the disposed assets were removed from the rolled forward regulatory asset base. This includes any income derived from the disposal of assets that were previously used beyond their Regulatory Lives, as described in Section 4.8.13;

FISDA_{t-1} = The estimated income (expressed in PhP) to a Regulated Entity that would arise from the sale of disposed assets that were previously part of the rolled forward regulatory asset base for a Regulated Distribution System during the 12-month period ending on December 31 in Regulatory Year t-1, calculated as:

$$FISDA_{t-1} = \frac{\sum FISDA_{j,t-1} + \sum FISDA_{j,t-2}}{2}$$

Where

$\sum FISDA_{j,t-1}$ = The sum of the estimated income (expressed in PhP) to a Regulated Entity that would arise during

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Regulatory Year t-1 from the sale of disposed assets in each asset category j (see Section 4.10.1 (a)), that were previously part of the rolled forward regulatory asset base for a Regulated Distribution System, as determined by the ERC as part of the Regulatory Reset Process for the Second or Third Regulatory Period under Article VII, after deducting any forecast expenses associated with the sale but excluding the value at which the disposed assets were forecast to be removed from the rolled forward regulatory asset base;

$\sum FISDA_{j,t-2}$ = The sum of the estimated income (expressed in PhP) to a Regulated Entity that would arise during Regulatory Year t-2 from the sale of disposed assets in each asset category j (see Section 4.10.1(a)), that were previously part of the rolled forward regulatory asset base for a Regulated Distribution System, as determined by the ERC as part of the Regulatory Reset Process for the Second or Third Regulatory Period under Article VII, after deducting any forecast expenses associated with the sale but excluding the value at which the disposed assets were forecast to be removed from the rolled forward regulatory asset base; and

CQ_{t-1} = The total amount of energy (expressed in kWh) delivered through the relevant Regulated Distribution System, during the 12-month period ending on December 31 in Regulatory Year t-1, to Distribution Connection Points in respect of that Regulated Distribution System, such amount of energy:

- being determined in a manner that is approved for this purpose by the ERC; and
- as so determined being audited to the satisfaction of the ERC by a person that is approved for this purpose by the ERC.

(b) The differential amount (expressed in PhP/kWh) for Regulatory Year t (DA_t) is calculated as follows:

$$DA_t = AWAT_t - [(0.50 \times MAP_{t-2}) + (0.50 \times MAP_{t-1})]$$

Where:

MAP_{t-1} = The maximum average price (expressed in PhP/kWh) that the Regulated Entity is permitted to charge for the provision by it, during Regulatory Year t-1, of Regulated Distribution Services in respect of the relevant Regulated Distribution System, as calculated in accordance with Section 4.2.1; and

MAP_{t-2} = The maximum average price (expressed in PhP/kWh) that the Regulated Entity is permitted to charge for the provision by it,

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during Regulatory Year t-2, of Regulated Distribution Services in respect of the relevant Regulated Distribution System, as calculated in accordance with Section 4.2.1;

and where Regulatory Year t is Regulatory Year 2012, $MAP_{t-2} = MAP_{2010}$ and $MAP_{t-1} = MAP_{2011}$ as has been determined by the ERC for the Second Regulatory Period;

and where Regulatory Year t is Regulatory Year 2013, $MAP_{t-2} = MAP_{2011}$ as has been determined by the ERC for the Second Regulatory Period.

4.3.2 The Correction Factor for each of the Regulatory Years in the Third Regulatory Period (K_t) is calculated as follows:

(a) if $DA_t < 0$, then

$K_t = DA_t \times (1 + i_t/100)$ (in such a case K_t will be a negative amount because DA_t is a negative amount);

(b) if $DA_t > 0$

and $[AWAT_t - (RBR_{t-1}/CQ_{t-1})] / [(0.5MAP_{t-1}) + (0.5MAP_{t-2})] < 1.07$

then

$K_t = DA_t [(1 + (i_t)/100)]$;

(c) if $DA_t > 0$

and $[AWAT_t - (RBR_{t-1}/CQ_{t-1})] / [(0.5MAP_{t-1}) + (0.5MAP_{t-2})] \geq 1.07$

(where \geq means greater than or equal to)

then

$K_t = DA_t [(1 + (i_t + 4)/100) - 0.04[(RBR_{t-1}/CQ_{t-1}) + 0.07(0.5MAP_{t-1} + 0.5MAP_{t-2})]$;

and

(d) if $DA_t = 0$, then

$K_t = 0$

Where:

MAP_{t-2} = Except as provided below, the maximum average price (expressed in PhP/kWh) that the Regulated Entity is permitted to charge for the provision by it, during Regulatory Year t-2, of Regulated Distribution Services in respect of the relevant Regulated Distribution System, as calculated in accordance with Section 4.2.1. (MAP_{t-2} may fall in the Second Regulatory Period);

MAP_{t-1} = The maximum average price (expressed in PhP/kWh) that the Regulated Entity is permitted to charge for the provision by it, during Regulatory Year t-1, of Regulated Distribution Services in respect of the relevant Regulated Distribution System, as calculated in accordance with Section 4.2.1. (MAP_{t-2} may fall in the Second Regulatory Period); and

i_t = The simple average of the monthly 180 day weighted-average Manila Reference Rate in nominal percent per annum terms published by the

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Bangko Sentral ng Pilipinas for the period from January 1 of
Regulatory Year t-2 to December 31 of Regulatory Year t-1.

4.3.3 Related business undertakings that utilize Regulated Distribution System assets may include, but are not limited to, the following:

- (a) service fees (for service connection or re-connection);
- (b) rental for distribution transformers;
- (c) rental for poles, boom and truck crane;
- (d) testing and calibration fees;
- (e) relocation and transfer fees;
- (f) inspection and installation fees;
- (g) illegal connection surcharge;
- (h) jobbing and contract fees;
- (i) engineering design on special projects;
- (j) rental of other utility property;
- (k) revenue from miscellaneous operations;
- (l) dividend income from investments made by Regulated Entities related to or using assets of the Regulated Distribution System; and
- (m) bad debts recovery.

4.4 Tax Adjustment

4.4.1 Except as otherwise provided in Section 4.2.1, the Tax Adjustment for Regulatory Year t (ITA_t) is calculated as follows:

$$ITA_t = \frac{(\text{ActTax}_{p, t-2} - \text{Tax}_{p, t-2}) \times (1 + \text{WACC}_t)^2}{\text{CQ}_{t-1}}$$

Where:

$\text{ActTax}_{p, t-2}$ = The amount of corporate income tax (expressed in PhP) that is actually paid, by the Regulated Entity that operates the relevant Regulated Distribution System, for Regulatory Year t-2 to the extent such tax relates to taxable income of that Regulated Entity (net of any related accumulated tax losses) which arises from the provision of Regulated Distribution Services in respect of that Regulated Distribution System by the Regulated Entity (whether or not such taxable income arises in Regulatory Year t-2);

$\text{Tax}_{p, t-2}$ = The estimated corporate income tax payable by that Regulated Entity in respect of the relevant Regulated Distribution System in Regulatory Year t-2 as calculated by the ERC in accordance with Sections 4.14.1 to 4.14.3;

WACC_t = The weighted average cost of capital as determined by the ERC which applies for the purposes of these Rules in respect of Regulatory Year t; and

CQ_{t-1} = The total amount of energy (expressed in kWh) delivered through the relevant Regulated Distribution System, during the 12 month period ending on December 31 in Regulatory Year t-1, to Distribution Connection Points in respect of that Regulated Distribution System, such amount of energy:

- (a) being determined in a manner that is approved for this purpose by the ERC; and
- (b) as so determined being audited to the satisfaction of the ERC by a person that is approved for this purpose by the ERC.

4.4.2 For the purposes of Section 4.4.1:

- (a) the amount of corporate income tax that is actually paid by a Regulated Entity for a Regulatory Year must be verified by returns received by the Bureau of Internal Revenue and evidence of payment by Authorized Agent Banks; and
- (b) the extent to which the tax referred to in paragraph (a) relates to taxable income of a Regulated Entity (net of any related accumulated tax losses) which arises from the provision of Regulated Distribution Services in respect of a Regulated Distribution System by the Regulated Entity must be certified by an auditor who:
 - is registered as a certified public accountant under the Revised Accountancy Law (Presidential Decree No.692);
 - possesses the independence as defined in Part II Section 14 of the Code of Professional Ethics for Certified Public Accountants as promulgated by the Board of Accountancy and approved by the Professional Regulation Commission; and
 - is one of the five largest auditing firms in the Philippines (as measured by annual revenue derived in the Philippines) or is approved by the ERC for the purposes of giving the certification referred to in this paragraph (b).

4.4.3 In accordance with Sections 4.7.7 and 4.14.4, the corporate income tax allowance included in the allowed revenue requirement for the Third Regulatory Period will be set to zero. As a result, there will be no tax adjustment applied for the Third Regulatory Period.

4.5 Change in Weighted Index

4.5.1 The change in Weighted Index for Regulatory Year t (CWI_t) is calculated as follows:

$$CWI_t = \{(W1 \times \text{DeltaCPI}_t) + (W2 \times \text{DeltaUSER}_t)\}$$

Where:

Subject to Section 4.20:

- (a) if Section 12.5.1 applies in respect of Regulatory Year t, W1 = 0.80; or
- (b) if Section 12.5.1 does not apply in respect of Regulatory Year t, W1 = 1;

Subject to Section 4.20:

- (a) if Section 12.5.1 applies in respect of Regulatory Year t, W2 = 0.20; or
- (b) if Section 12.5.1 does not apply in respect of Regulatory Year t, W2 = 0;

DeltaCPI_t is the change in CPI for Regulatory Year t and is calculated in accordance with Section 4.5.2; and

DeltaUSER_t is the change in the PhP/\$US exchange rate for Regulatory Year t and is calculated in accordance with Section 4.5.3.

4.5.2 The change in CPI for Regulatory Year t (DeltaCPI_t) is calculated as follows (assuming all index data is derived from, or adjusted to, the same base year⁴):

$$\text{DeltaCPI}_t = (\text{CPI}_{t-1} / \text{CPI}_{t-2}) - 1$$

Where:

$$\text{CPI}_{t-1} = \{ \text{CPI}_{(Q4, t-2)} + \text{CPI}_{(Q1, t-1)} + \text{CPI}_{(Q2, t-1)} + \text{CPI}_{(Q3, t-1)} \}; \text{ and}$$

$$\text{CPI}_{t-2} = \{ \text{CPI}_{(Q4, t-3)} + \text{CPI}_{(Q1, t-2)} + \text{CPI}_{(Q2, t-2)} + \text{CPI}_{(Q3, t-2)} \}$$

where:

CPI_(Q4, t-2) is the CPI for the Quarter ending on June 30 in year t-2;

CPI_(Q1, t-1) is the CPI for the Quarter ending on September 30 in year t-1;⁵

CPI_(Q2, t-1) is the CPI for the Quarter ending on December 31 in year t-1;

CPI_(Q3, t-1) is the CPI for the Quarter ending on March 31 in year t-1;

CPI_(Q4, t-3) is the CPI for the Quarter ending on June 30 in year t-3;

CPI_(Q1, t-2) is the CPI for the Quarter ending on September 30 in year t-2;

CPI_(Q2, t-2) is the CPI for the Quarter ending on December 31 in year t-2; and

CPI_(Q3, t-2) is the CPI for the Quarter ending on March 31 in year t-2.

4.5.3 The change in the PhP/\$US exchange rate for Regulatory Year t (DeltaUSER_t) is calculated as follows (assuming all US consumer price index data is derived from, or adjusted to, the same base year⁶):

$$\text{DeltaUSER}_t = \{ (\text{USER}_{t-1} / \text{USER}_{t-2}) \times (\text{USCPI}_{t-1} / \text{USCPI}_{t-2}) \} - 1$$

Where:

$$\text{USER}_{t-1} = \{ \text{USER}_{(Q4, t-2)} + \text{USER}_{(Q1, t-1)} + \text{USER}_{(Q2, t-1)} + \text{USER}_{(Q3, t-1)} \};$$

and

$$\text{USER}_{t-2} = \{ \text{USER}_{(Q4, t-3)} + \text{USER}_{(Q1, t-2)} + \text{USER}_{(Q2, t-2)} + \text{USER}_{(Q3, t-2)} \}$$

where:

⁴ CPI information from the National Statistics Office of the Philippines (NSO) currently uses an index base of “2000 = 100”. In the future, should the NSO change the base year for its reported CPI, the CPI values used in Section 4.5.2 must all be adjusted to use the same base year (see Section 4.5.4).

⁵ Note that the reference to year refers to Regulatory Year. For example, if the Regulatory Year is 2014 and ends on June 30, 2014, the term CPI_(Q1, t-1) refers to the CPI index for the first quarter in the previous Regulatory Year, or the end of the September Quarter of Regulatory Year 2013. That is the Quarter ending on September 30, 2012.

⁶ If the base year for any such US consumer price index data should change, the values used in Section 4.5.3 must all be adjusted to use the same base year (see Section 4.5.4).

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USER for a Quarter (Q) is the average of the Philippine Peso/United States Dollar inter-bank mid-rates prevailing on each of the last 5 Business Days of that Quarter, each such rate being as published by the Bangko Sentral ng Pilipinas, expressed as PHP/US\$1 (for example, if PHP50 can purchase US\$1, then USER is 50);

$USER_{(Q4, t-2)}$ is the USER for the Quarter ending on *June 30* in year t-2;

$USER_{(Q1, t-1)}$ is the USER for the Quarter ending on *September 30* in year t-1;

$USER_{(Q2, t-1)}$ is the USER for the Quarter ending on *December 31* in year t-1;

$USER_{(Q3, t-1)}$ is the USER for the Quarter ending on *March 31* in year t-1;

$USER_{(Q4, t-3)}$ is the USER for the Quarter ending on *June 30* in year t-3;

$USER_{(Q1, t-2)}$ is the USER for the Quarter ending on *September 30* in year t-2;

$USER_{(Q2, t-2)}$ is the USER for the Quarter ending on *December 31* in year t-2; and

$USER_{(Q3, t-2)}$ is the USER for the Quarter ending on *March 31* in year t-2; and

$USCPI_{t-1} = \{USCPI_{(Q4, t-2)} + USCPI_{(Q1, t-1)} + USCPI_{(Q2, t-1)} + USCPI_{(Q3, t-1)}\};$
and

$USCPI_{t-2} = \{USCPI_{(Q4, t-3)} + USCPI_{(Q1, t-2)} + USCPI_{(Q2, t-2)} + USCPI_{(Q3, t-2)}\}$

where:

USCPI for a Quarter (Q) is the Consumer Price Index for all urban customers, US city average published by the US Bureau of Labour Statistics for the last month of that Quarter in series CUUR 0000SAO;

$USCPI_{(Q4, t-2)}$ is the USCPI for the Quarter ending on *June 30* in year t-2;

$USCPI_{(Q1, t-1)}$ is the USCPI for the Quarter ending on *September 30* in year t-1;

$USCPI_{(Q2, t-1)}$ is the USCPI for the Quarter ending on *December 31* in year t-1;

$USCPI_{(Q3, t-1)}$ is the USCPI for the Quarter ending on *March 31* in year t-1;

$USCPI_{(Q4, t-3)}$ is the USCPI for the Quarter ending on *June 30* in year t-3;

$USCPI_{(Q1, t-2)}$ is the USCPI for the Quarter ending on *September 30* in year t-2;

$USCPI_{(Q2, t-2)}$ is the USCPI for the Quarter ending on *December 31* in year t-2;
and

$USCPI_{(Q3, t-2)}$ is the USCPI for the Quarter ending on *March 31* in year t-2.

- 4.5.4 If a source of data described in this Section 4.5 is no longer published, or if any other change occurs in relation to such data which would cause the continued use of the source to result in inaccurate comparisons between data calculated using the source prior to the change and data calculated using the source after the change, then such alternative source as the ERC reasonably determines, after consultation with each Regulated Entity, will be substituted.

4.6 General Building Block Principles

- 4.6.1 As part of the Regulatory Reset Process for the Third Regulatory Period under Article VII, the ERC must determine the Annual Revenue Requirement for each

Regulated Distribution System for each Regulatory Year t in the Third Regulatory Period (ARR_t). The ARR_t must be based on a forward-looking analysis of forecast cash flow requirements and must represent the optimal forecast revenue requirement, in relation to that Regulated Distribution System and for each Regulatory Year of the Third Regulatory Period, of the Regulated Entity that operates that Regulated Distribution System. The ARR_t must reasonably compensate the Regulated Entity for the economically efficient costs and risks it incurs in providing Regulated Distribution Services in respect of that Regulated Distribution System in order to encourage:

- (a) a commercial environment which is transparent and stable, and which does not discriminate between the users of those Regulated Distribution Services;
- (b) the same outcomes in the market for those Regulated Distribution Services as would be achieved if that market were competitive;
- (c) competition in the provision of those Regulated Distribution Services wherever practicable;
- (d) the commercial viability of the Regulated Entity through allowing it to recover its efficient costs associated with the provision of those Regulated Distribution Services, together with a reasonable return on the Regulated Entity's approved capital invested in that Regulated Distribution System, as determined by the ERC;
- (e) competition in upstream and downstream markets;
- (f) stability in the distribution wheeling rates charged for those Regulated Distribution Services;
- (g) recovery of only those costs which are related to the provision of those Regulated Distribution Services;
- (h) fairness in the charges made for those Regulated Distribution Services, including through the progressive removal of cross-subsidies;
- (i) as a minimum, maintenance of service delivery levels subsisting at the beginning of the Third Regulatory Period and an improvement of service delivery levels during that period as contemplated by Article VIII; and
- (j) maintenance of that Regulated Distribution System such that, at the end of the term of the Third Regulatory Period, that Regulated Distribution System is able to continue to provide sustainable electricity distribution service delivery into the future without above average expenditure on upgrades or critical maintenance, and with the ability of continuing the service delivery levels previously achieved.

4.6.2 The ARR_t for a Regulated Distribution System must result from an economic and financial analysis of the forecast cash flow requirements, in relation to that Regulated Distribution System, of the Regulated Entity that operates that Regulated Distribution System, such forecast cash flow requirements being based on a Building Block analysis pursuant to Section 4.7 which uses a 'classical' weighted average cost of capital as defined in Section 4.11.

- 4.6.3 Any taxes, other than corporate income tax, must be included as a specific line item in the Building Blocks alongside the operating and maintenance expenditures to which they are related.
- 4.6.4 When undertaking the economic and financial analysis to determine the ARR_t for a Regulated Distribution System, the ERC will adequately compensate the relevant Regulated Entity for all identified and justifiable risks inherent in an electricity distribution business in the Philippines, it being recognized that the over compensation for such risks will be to the disadvantage of Customers of that Regulated Distribution System because it will permit unjustifiably high tariffs and that the under compensation for such risks will be to the disadvantage of the Regulated Entity (and ultimately Customers of that Regulated Distribution System) because it will adversely affect the viability of the Regulated Entity.

4.7 Primary Building Blocks

- 4.7.1 The financial Building Blocks which will form the basis of calculating the ARR_t for a Regulated Distribution System are as follows:
- operating and maintenance expenditure;
 - taxes other than corporate income tax;
 - regulatory depreciation;
 - return 'on' capital; and
 - corporate income tax
- 4.7.2 The operating and maintenance expenditure for Regulatory Year t is constituted by the forecasts of such expenditure in relation to the relevant Regulated Distribution System for that Regulatory Year, as approved by the ERC in accordance with Section 4.13.
- 4.7.3 The taxes, other than corporate income tax, for Regulatory Year t are constituted by the forecasts of payments of such taxes as are expected to be incurred in relation to the relevant Regulated Distribution System for that Regulatory Year, as approved by the ERC in accordance with Section 4.13.
- 4.7.4 The Regulatory Depreciation for Regulatory Year t is that which is determined by the ERC in respect of the relevant Regulated Distribution System on the basis of the methodology for its determination set out in Section 4.10.2.
- 4.7.5 The return 'on' capital for Regulatory Year t is the Regulatory Asset Base for the relevant Regulated Distribution System for that Regulatory Year (RAB_t), as determined by the ERC on the basis of the methodology for its determination set out in Section 4.9, increased by an allowance for working capital in accordance with Section 4.7.7, multiplied by the classical weighted average cost of capital (WACC), as determined by the ERC in accordance with Section 4.11.
- 4.7.6 The corporate income tax for Regulatory Year t is the estimated corporate income tax payable by the Regulated Entity in respect of the relevant Regulated Distribution System in that Regulatory Year as determined by the ERC in accordance with Sections 4.14.1 to 4.14.3. For the Third Regulatory Period, this will be set to zero.

4.7.7 The Building Block formula to be used in calculating the ARR_t for a Regulated Distribution System is as follows:

$$ARR_t = Opex_t + Tax_{m,t} + RegDepn_t + [(RAB_t + WC_t) \times WACC] + Tax_{p,t}$$

Where:

$Opex_t$ = The nominal⁷ operating and maintenance expenditure in relation to the relevant Regulated Distribution System for Regulatory Year t which is forecasted for that Regulatory Year and approved by the ERC in accordance with Section 4.13;

$Tax_{m,t}$ = The payment of taxes, other than corporate income tax, for Regulatory Year t in nominal terms which are forecasted to be incurred in relation to the relevant Regulated Distribution System for that Regulatory Year and which are approved by the ERC in accordance with Section 4.13;

$RegDepn_t$ = The Regulatory Depreciation for Regulatory Year t in real⁸ terms as determined by the ERC in respect of the relevant Regulated Distribution System on the basis of the methodology for its determination set out in Section 4.10.2;

RAB_t = The Regulatory Asset Base for the relevant Regulated Distribution System for Regulatory Year t in real terms as determined by the ERC on the basis of the methodology for its determination set out in Section 4.9;

WC_t = The working capital allowance for Regulatory Year t, which is set at a proportion of the difference between:

- (a) the real operating and maintenance expenditure in relation to the relevant Regulated Distribution System which is forecasted for that Regulatory Year and approved by the ERC in accordance with Section 4.13; and
- (b) the real amount of the bad debts in relation to the relevant Regulated Distribution System which are forecasted for that Regulatory Year and approved by the ERC in accordance with Section 4.13,

such proportion being determined by the ERC, as part of the Regulatory Reset Process for the Third Regulatory Period under Article VII, after an analysis of the relevant payables and receivables (which analysis could take the form of a lead/lag study, a benchmark study, or an industry average study focused on private utilities);

⁷ In these Guidelines the word 'nominal' is used with its financial meaning, such that nominal peso numbers are represented with inflation applied, and are in pesos of the day. Notionally these are *June 30* year end figures unless stated otherwise.

⁸ In these Guidelines the word 'real' is used with its financial meaning, such that real peso numbers are represented without inflation applied. Notionally these are *June 30* year end figures unless stated otherwise.

- WACC = The weighted average cost of capital calculated using a 'classical' formula and as determined by the ERC in accordance with Section 4.11. This value is determined by the ERC as part of the Regulatory Reset Process for the Third Regulatory Period under Article VII and remains constant for each Regulatory Year in the Third Regulatory Period unless a re-opening event occurs as described in Section 12.6 ; and
- Tax_{p,t} = The estimated corporate income tax payable by the relevant Regulated Entity in respect of the relevant Regulated Distribution System in Regulatory Year t in nominal terms as determined by the ERC in accordance with Sections 4.14.1 to 4.14.3. For the Third Regulatory Period, this value will be set to zero.

4.8 Asset Valuation

4.8.1 Prior to the commencement of the Third Regulatory Period an asset re-valuation must be undertaken in relation to each Regulated Distribution System in accordance with this Section 4.8 (the " Re-valuation"). The Re-valuation will be carried out on the Regulatory Asset Base as it exists for the provision of Regulated Distribution Services for a Regulated Entity at the Re-valuation date - such date which will be set by the ERC for each Entry Group, but which will be not less than 15 months prior to the start of the Third Regulatory Period.

4.8.2 The asset Re-valuation referred to in Section 4.8.1 must be undertaken by either:

- (a) an independent appraisal company engaged by the Regulated Entity that operates the relevant Regulated Distribution System, in which case the ERC must also retain a Regulatory Reset Expert or Regulatory Reset Experts pursuant to Article XIV for the purposes of reviewing that re-valuation; or
- (b) a Regulatory Reset Expert or Regulatory Reset Experts retained by the ERC pursuant to Article XIV for the purposes of undertaking that re-valuation,

the choice of which option is adopted being at the discretion of the ERC after consulting with the relevant Regulated Entity. Where:

- (c) paragraph (a) applies - both the independent appraisal company and the Regulatory Reset Expert or Regulatory Reset Experts referred to in that paragraph must comply with the requirements relating to the Re-valuation, and (in so far as their reports are concerned) the requirements relating to the Re-valuation Report, as set out in this Section 4.8, the independent appraisal company must provide its asset re-valuation report to the ERC at the latest by 14 months prior to the commencement of the Third Regulatory Period and the review of that report by the Regulatory Reset Expert or Regulatory Reset Experts referred to in paragraph (a) must be provided to the ERC at the latest by 13 months prior to the commencement of the Third Regulatory Period (for the purposes of this Section 4.8, the report of the independent appraisal company as modified by the report of the Regulatory Reset Expert or Regulatory Reset Experts is referred to as the " Re-valuation Report" for the relevant Regulated Distribution System);
- (d) paragraph (b) applies – the Regulatory Reset Expert or Regulatory Reset Experts referred to in that paragraph must comply with the requirements relating to the

Re-valuation, and (in so far as their asset re-valuation report is concerned) the requirements relating to the Re-valuation Report, as set out in this Section 4.8, and they must provide their asset e-valuation report to the ERC at the latest by 13 months prior to the commencement of the Third Regulatory Period (for the purposes of this Section 4.8, the report of the Regulatory Reset Expert or Regulatory Reset Experts is referred to as the " Re-valuation Report" for the relevant Regulated Distribution System).

4.8.3 Where the re-valuation undertaken pursuant to Section 4.8.1 shows that an asset that has previously been optimized out of the regulatory asset base for a Regulated Distribution System should be included in the regulatory asset base for that Regulated Distribution System for the Third Regulatory Period, the following principles relating to the treatment of that asset must be employed:

- (a) the value at which that asset must be included in that regulatory asset base is its regulatory asset base value as at the date of its exclusion from the regulatory asset base; and
- (b) that asset must be included in that regulatory asset base in the Regulatory Year in the Third Regulatory Period in which the asset is forecasted to be required to support the provision of Regulated Distribution Services in respect of that Regulated Distribution System by the Regulated Entity, and the asset must be depreciated (in an accelerated manner) over its remaining economic life as if it had never been optimized out of the regulatory asset base.

4.8.4 As part of the Regulatory Reset Process under Article VII for Subsequent Regulatory Periods following the Third Regulatory Period, and subject to Section 4.8.5, the ERC must require that either:

- (a) the regulatory asset base for a Regulated Distribution System is re-valued. The re-valuation must value the material items of plant and equipment either:
 - at their optimized deprival value (i.e. at the lesser of their optimized depreciated replacement cost and their recoverable amount (their recoverable amount being the greater of their economic value and net realizable value)); or
 - using some other method of internationally-accepted valuation methodology as determined by the ERC; or
- (b) the previous value of the regulatory asset base for a Regulated Distribution System is rolled-forward, in which case the provisions of Sections 4.8.15 and 4.8.16 will apply with such modifications as are necessary in respect of such roll-forward.

However, any assets previously optimized out of the regulatory asset base for a Regulated Distribution System will be included in that regulatory asset base if the ERC is satisfied that those assets are required to support the provision of Regulated Distribution Services in respect of that Regulated Distribution System by the Regulated Entity, in which case the principles set out in Section 4.8.3 must be employed in relation to the treatment of those assets.

4.8.5 Notwithstanding Section 4.8.4(a), the value of any Transferred Subtransmission Assets must be determined in accordance with Section 4.8.15.

- 4.8.6 The ERC must adopt the same alternative under Section 4.8.4 in respect of all Regulated Entities and all Regulated Distribution Systems for the same Subsequent Regulatory Period.
- 4.8.7 If, subject to Section 4.8.4, the Re-valuation in relation to a Regulated Distribution System is undertaken using an optimized replacement cost approach, the following applies:
- (a) the ERC will appoint a Regulatory Reset Expert to assist it to develop a Valuation Handbook that will specify:
 - the optimized replacement cost valuation guidelines that will be adopted for the Third Regulatory Period, including the optimization principles;
 - standard replacement costs for asset types commonly used by Regulated Entities in the Philippines;
 - standard asset lives for asset types commonly used by Regulated Entities in the Philippines;
 - multiplier ranges that will account for differences between various distribution networks or parts of distribution networks in terms of the environment in which networks are installed (CBD or dense commercial, medium commercial, dense residential, normal residential or barangays, and rural areas) or the geological nature of the area in which networks are installed (rock, hard soil or soft soil);
 - other factors that should be added to account for exceptional factors influencing network replacement costs, such as exceptional traffic density, exceptional population density or areas requiring exceptional safety precautions; and
 - the treatment of non-standard assets that are not listed in the standard replacement cost schedules, or of assets installed in special circumstances.
 - (b) the standard rates and asset lives used in this Valuation Handbook will be developed taking into account the asset valuation carried out on all Regulated Entities during the Second Regulatory Period, as well as further evidence collected on standard asset replacement costs throughout the Philippines;
 - (c) the replacement values used in the Valuation Handbook will be escalated annually in accordance with the Philippines CPI or another price escalation index as determined during the development of the Valuation Handbook or during any reset process; and
 - (d) the Valuation Handbook will only be finalized after full public consultation with all interested parties. The publication date of the Valuation Handbook will be not later than March 31, 2010.
- 4.8.8 The Re-valuation in relation to a Regulated Distribution System must be undertaken utilizing more than a single weighted average asset category, taking into account the asset types described in the Valuation Handbook. The details of the re-valuation must be reconciled back to the relevant Regulated Entity's asset register or general ledger (as required), and such reconciliation must be fully documented in advance of the submission of the relevant Re-valuation Report to the ERC. The Re-valuation

Report must specify the reported re-valued asset values, the sources of the information used in calculating those values, and the weighted average age of the assets, for the following Asset Categories j:

(a) Regulated Distribution Services Assets

i. Distribution services

- Land and Land Rights (dedicated to distribution purposes)
- Structures and Improvements (dedicated to distribution purposes)
- Substation Equipment - Power transformers
 - Switchgear
 - Protective equipment
 - Metering and control equipment
 - Communications equipment
 - Other station equipment
- Poles, Towers and Fixtures
- Overhead Conductors and Devices
- Underground Conduits
- Underground Conductors and Devices
- Distribution transformers
- Power conditioning equipment⁹
- Meters, Metering Instruments & Metering Transformers (dedicated to distribution purposes)
- Information technology equipment (dedicated to distribution purposes)
- Regulated Entity property on Consumers' Premises (not forming part of Distribution Connection Assets)
- Street Lights and Signal Systems
- Submarine Cables

ii. General Plant (Non-network Assets)

- Land and Land Rights (non-network related)
- Structures and Improvements (non-network related)
- Office Furniture and Equipment
- Transportation Equipment
- Stores Equipment
- Tools, Shop and Garage Equipment
- Laboratory Equipment
- Information systems equipment (non-network related)

⁹ This refers to equipment such as capacitor banks for power factor correction, voltage regulators, generators used for spinning reserve or voltage stability, VAR compensators etc..

- Power-operated Equipment
 - Communication Plant and Equipment
 - Miscellaneous Equipment
- iii. Materials and Supplies, including spares
- iv. Transferred Sub-transmission Assets
- b) Distribution Connection Services Assets
- i. Distribution services
- Poles, Towers and Fixtures
 - Overhead Conductors and Devices
 - Underground Conduits
 - Underground Conductors and Devices
 - Distribution Transformers
 - Information technology equipment (dedicated to Distribution Connection Services)
- ii. General Plant (Non-network Assets)
- Land and Land Rights (non-network related)
 - Structures and Improvements (non-network related)
 - Office Furniture and Equipment
 - Transportation Equipment
 - Stores Equipment
 - Tools, Shop and Garage Equipment
 - Laboratory Equipment
 - Information systems equipment (non-network related)
 - Power-operated Equipment
 - Communication Plant and Equipment
 - Miscellaneous Equipment
- iii. Materials and Supplies, including spares
- c) Regulated Retail Services Assets
- Meters, Metering Instruments & Metering Transformers – Consumer consumption metering
 - Land and Land Rights
 - Structures and Improvements
 - Office Furniture and Equipment
 - Transportation Equipment
 - Stores Equipment

- Tools, Shop and Garage Equipment
- Laboratory Equipment
- Information systems equipment
- Communication Plant and Equipment
- Miscellaneous Equipment

d) any other Asset Categories specified by the ERC.

Where construction projects have commenced before the Revaluation Date but will only be completed after this date, assets fully completed and commissioned before the date of the Revaluation will be included in the Revaluation Report (unless optimized out in terms of the Valuation Handbook). In addition, capital expenditure incurred on completed and commissioned assets added to the Regulatory Asset Base in the period between the Revaluation Date and the start of the Third Regulatory Period, will also be included in the Revaluation Report, unless optimized out in terms of the Valuation Handbook. Such assets will be included in the Regulatory Asset Base and valued in terms of the Valuation Handbook.

A Construction Work in Progress (CWIP) factor as described in Section 4.8.12 will be applied by the ERC to the assets included in the Revaluation when determining the value of the Rolled-forward Depreciated Regulatory Asset Base as described in Section 4.8.13. To avoid double-recovery, the Regulatory Reset Expert has to ensure that no allowance for interest during construction or other similar mechanisms are included in the asset values used in the Re-valuation Report.

- 4.8.9 In undertaking the optimization of the Re-valuation of the assets based on replacement cost, the optimization principles described in the Valuation Handbook will be employed. Further optimization principles, as long as these do not contradict the Valuation Handbook, may be used as approved by the ERC following advice from a Regulatory Reset Expert or Regulatory Reset Experts referred to in Section 4.8.2. Such principles must include the manner in which windfall gains and losses arising from an Re-valuation are to be treated. It is given that changes in the RDWR, including the aforementioned further optimization principles, are subjected to full public consultations.
- 4.8.10 The Re-valuation Date in relation to a Regulated Distribution System will be set by the ERC but must be not be later than fifteen (15) months prior to the commencement of the Third Regulatory Period.
- 4.8.11 The Re-valuation Report for a Regulated Distribution System must differentiate between those assets which are to be included in the Regulatory Asset Base for that Regulated Distribution System and those assets which are to be excluded from that Regulatory Asset Base on the basis that the Regulatory Asset Base must only include assets to the extent that such assets:
- (a) are necessary to meet Customer requirements for Regulated Distribution Services in respect of the Regulated Distribution System within the electricity distribution network planning horizon referred to in the optimization principles described in Appendix D;
 - (b) except in the case of spares, are in service (i.e. have been commissioned and are providing a service);

- (c) in the case of spares, are in reasonable quantities as determined by the ERC (following the provision to the ERC, pursuant to Section 7.1.2(b), of information relating to usage and delivery lags); and
- (d) in the case of easements, are clearly documented as being owned by the Regulated Entity.

4.8.12 For the purposes of Sections 4.8.13 the Construction Work in Progress (CWIP) Factor as it applies in respect of all assets or an Asset Category is intended to compensate for the investment cost (i.e. the time value of money), calculated using a typical spend profile for assets of the relevant type (at the weighted average cost of capital determined by the ERC in accordance with Section 4.11), over the typical period from the commencement of the construction of such assets to the commissioning of those assets (excluding any periods of unjustified delay). For these purposes, the "spend profile" is to be determined as the average expenditure on those types of assets in relation to past projects undertaken in respect of the relevant Regulated Distribution System, calculated on a project and month-by-month basis over the whole life of each such project from budget approval to commissioning.¹⁰ The CWIP Factor must be derived from a calculation method approved by the ERC which could take the form of:

- (a) uniformly escalating the optimized depreciated replacement cost of the re-valued assets by a constant factor; or
- (b) directly estimating the investment cost for specific past projects and adding this cost to the optimized replacement cost of the re-valued assets; or
- (c) another method approved by the ERC.

The CWIP Factor may be the same for all revalued assets or may differ as between Asset Categories.

4.8.13 The ERC must estimate, in respect of that Regulated Distribution System, the value of the Rolled-forward Depreciated Regulatory Asset Base for each Asset Category j as at the commencement of the first Regulatory Year (t) in the Third Regulatory Period ($RAB_{oj,t}$). It will be assisted in this estimate by the Regulatory Reset Expert retained or internal review team created in terms of Section 4.12.4 for the purposes of reviewing the forecasted capital expenditure of a Regulated Distribution System. For these purposes, $RAB_{oj,t}$ is equal to $RAB_{cj,t-1}$ as calculated in accordance with the formula specified in Section 4.9.2 except that, for the purposes of applying that formula:

- (a) $RAB_{oj,t-1}$ will be deemed to be the value of each asset in Asset Category j that is to be included in the regulatory asset base for that Regulated Distribution System (as defined in Section 4.8.8) and that is in existence as at the date of the Re-valuation in relation to that Regulated Distribution System, such value being:
 - where Asset Category j does not comprise Transferred Subtransmission Assets – the optimized depreciated replacement cost of those assets as at

¹⁰ This average can be calculated on the basis of two or more projects of similar size and complexity, but should be reasonably representative of capital expenditure projects undertaken in respect of the relevant Regulated Distribution System in the normal course of business.

the Re-valuation Date increased by the application of the relevant CWIP Factor (except that the CWIP Factor must not be applied to the extent an asset is categorised as part of spares, easements, buildings, civil works and establishment, or non-system assets); and

- where Asset Category j comprises Transferred Subtransmission Assets – the value of those assets as at the Re-valuation Date, as determined in accordance with Section 4.8.12;
- (b) $Capex_{j,t-1}$ will be deemed to be the actual or budgeted capital expenditure of the relevant Regulated Entity on assets in Asset Category j for the period from the date of that Re-valuation in relation to that Regulated Distribution System to the date of commencement of the Third Regulatory Period to the extent such expenditure is reasonable and to the extent it is attributable to assets which would (if they had been in existence as at the Re-valuation Date) be included in the regulatory asset base for that Regulated Distribution System (as defined in Section 4.8.8), increased by the application of the relevant CWIP Factor, except that the CWIP Factor must not be applied to the extent the relevant capital expenditure is:
- on an asset that is categorised as part of spares, easements, buildings, civil works and establishment, or non-system assets; or
 - on a Transferred Subtransmission Asset;
- (c) $RegDepn_{oj,t-1}$ will be deemed to be the Regulatory Depreciation of those assets in Asset Category j that are to be included in the Regulatory Asset Base for that Regulated Distribution System (as defined in Section 4.8.11), and that are in existence as at Re-valuation Date in relation to that Regulated Distribution System, excluding spares, easements and land, such Regulatory Depreciation being calculated in accordance with Section 4.10.1 (but as if the reference to Regulatory Year t in that Section were instead a reference to the period from the Re-valuation Date to the date of commencement of the Third Regulatory Period);
- (d) $RegDepn_{cj,t-1}$ will be deemed to be the Regulatory Depreciation of the capital expenditure on assets in Asset Category j, which is referred to in Section 4.8.10(b), excluding spares, easements and land, such Regulatory Depreciation being calculated consistently with the methodology set out in Section 4.10.1 (but as if the reference to Regulatory Year t in that Section were instead a reference to the period:
- from (in the case of an asset that is not a Transferred Subtransmission Asset) the actual or budgeted date of commissioning of the asset or (in the case of an asset that is a Transferred Subtransmission Asset) the actual or budgeted date of the transfer of the asset from TransCo or NGCP to the relevant Regulated Entity;
 - to the date of commencement of the Third Regulatory Period); and
- (e) $Disposals_{j,t-1}$ will be deemed to be the actual or budgeted net receipts from the disposal, during the period from the Re-valuation Date in relation to that Regulated Distribution System to the date of commencement of the Third Regulatory Period, of assets in Asset Category j that are to be included in the regulatory asset base for that Regulated Distribution System (as defined in

Section 4.8.8) to the extent such net receipts are reasonable. The net receipts from the disposal of such an asset will be determined as the receipts from the disposal of that asset, minus the value of that asset at the actual or budgeted date of its disposal. The value of that asset at the actual or budgeted date of its disposal will be determined as the rolled-forward depreciation regulatory asset base value of that asset at that time.

- 4.8.14 The Re-valuation Report for a Regulated Distribution System must also identify the historical cost of the regulatory asset base for that Regulated Distribution System (as defined in Section 4.8.8) at the Re-valuation Date in relation to that Regulated Distribution System. Such historical cost must be depreciated in a similar manner to the Rolled-forward Depreciated Regulatory Asset Base for that Regulated Distribution System under Section 4.8.10 to obtain the opening written-down historical cost of that regulatory asset base at the commencement of the first Regulatory Year in the Third Regulatory Period. Further, the opening written-down historical cost must be rolled-forward for the Third Regulatory Period in a similar manner to the Rolled-forward Depreciated Regulatory Asset Base for that Regulated Distribution System under Section 4.9 to obtain an opening written-down historical cost of that regulatory asset base at the commencement of each subsequent Regulatory Year in the Third Regulatory Period. These written-down historical costs are used in the Building Block methodology to determine the $HCDepn_{t-1}$ as set out in Section 4.14.3.
- 4.8.15 Notwithstanding the foregoing, any Transferred Subtransmission Assets must be valued at their Revenue Potential adjusted for the effect of inflation, capital expenditure on them and depreciation between:
- (a) the date of the transfer of those assets from TransCo or NGCP to the relevant Regulated Entity; and
 - (b) the date of the valuation,
 - (c) such adjustment to be made in such manner as is specified for that purpose in these Rules or (in the absence of such specification) as is approved for that purpose by the ERC. For the avoidance of doubt, Sections 4.8.4 and 4.8.6 do not apply to any Transferred Subtransmission Assets.
- 4.8.16 Assets remaining in service beyond their regulatory life as described in Section 4.10.1(a), will remain part of the regulatory asset base and will be valued at 5% of their optimized replacement cost. Such assets and their residual value must be separately identified in the Re-valuation Report. Since the Regulatory Depreciation on these assets would have been completely recovered, this 5% residual value is used for the purposes of calculating a return on the regulatory asset base only (in accordance with Sections 4.7.7 and 4.9.1). There will be no further depreciation on these assets and at such time that they are finally removed from service, there will be no further disposal value in terms of Section 4.10.1. Any revenue derived from the sale of assets thus disposed will however be taken into account for the purposes of Section 4.3.1.

4.9 Regulatory Asset Base

4.9.1 The Regulatory Asset Base for a Regulated Distribution System for any Regulatory Year t (RAB_t) is derived from a roll-forward calculation of the value of each Asset Category j and is calculated as follows:

$$RAB_t = [(RAB_{o,t} + AORL_{o,t}) + (RAB_{c,t} + AORL_{c,t})] / 2$$

Where:

$RAB_{o,t}$ = In the case where Regulatory Year t is the first Regulatory Year in the Third Regulatory Period, the sum across the Asset Categories j of the Rolled-forward Depreciated Regulatory Asset Base for each Asset Category j as at the commencement of the first Regulatory Year in the Third Regulatory Period ($RAB_{oj,t-1}$) as determined by the ERC under Section 4.8.13; or

= In the case where Regulatory Year t is a Regulatory Year (other than the first Regulatory Year) in the Third Regulatory Period, the sum across the Asset Categories j of the opening Rolled-forward Depreciated Regulatory Asset Base for each Asset Category j for that Regulatory Year t ($RAB_{oj,t} = RAB_{cj,t-1}$), as defined in Section 4.9.2;

$RAB_{c,t}$ = The sum across the Asset Categories j of the closing Rolled-forward Depreciated Regulatory Asset Base for each Asset Category j for Regulatory Year t ($RAB_{cj,t}$), as defined in Section 4.9.2;

$AORL_{o,t}$ = In the case where Regulatory Year t is the first Regulatory Year in the Third Regulatory Period, the sum across the Asset Categories j of the 5% residual value of assets that are remaining in service beyond their regulatory lives for each Asset Category j as at the commencement of the first Regulatory Year in the Third Regulatory Period ($RAB_{oj,t-1}$), as determined by the ERC under Section 4.8.13; or

= In the case where Regulatory Year t is a Regulatory Year (other than the first Regulatory Year) in the Third Regulatory Period, the sum across the Asset Categories j of the opening 5% residual value of assets remaining in service beyond their regulatory lives for each Asset Category j for that Regulatory Year t ($AORL_{oj,t} = AORL_{cj,t-1}$) as determined by the ERC under Section 4.8.14;

$AORL_{cj,t}$ = The sum across the Asset Categories j of the 5% closing residual value of assets that are remaining in service beyond their regulatory lives for each Asset Category j for Regulatory Year t as determined by the ERC under Section 4.8.14; and

$$AORL_{cj,t} = AORL_{oj,t} + (AORLA_{j,t} - AORLR_{j,t})$$

Where:

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AORLA_{j,t} = The 5% residual value of assets in category j reaching the end of their regulatory lives during Regulatory Year t; and

AORLR_{j,t} = The 5% residual value previously recorded as part of RAB_t for assets in category j that were previously used beyond their regulatory lives but have been disposed of during Regulatory Year t.

(This value should not be included as part of the disposals described in Section 4.9.2.)

4.9.2 The closing Rolled-forward Depreciated Regulatory Asset Base, in respect of a Regulated Distribution System, for Asset Category j for Regulatory Year t (RAB_{cj,t}) is calculated as follows:

$$RAB_{cj,t} = RAB_{oj,t} - \text{RegDepn}_{oj,t} + \text{Capex}_{j,t} - \text{RegDepn}_{cj,t}$$

Where:

RAB_{oj,t} = The opening Rolled-forward Depreciated Regulatory Asset Base for Asset Category j for Regulatory Year t, which is numerically equal to RAB_{cj,t-1} except that, where Regulatory Year t is the first Regulatory Year in the Third Regulatory Period, RAB_{oj,t} is the Rolled-forward Depreciated Regulatory Asset Base for Asset Category j as at the commencement of the first Regulatory Year in the Third Regulatory Period as determined by the ERC under Section 4.8.13;

RegDepn_{oj,t} = The Regulatory Depreciation, for Regulatory Year t, of those assets in Asset Category j (excluding spares, land and easements) that were included in the Rolled-forward Depreciated Regulatory Asset Base for Asset Category j as at the commencement of the first Regulatory Year in the Third Regulatory Period as determined by the ERC consistently with its determination under Section 4.8.13 and with the method for calculating the Regulatory Depreciation for that Asset Category as set out in Section 4.10.1;

Capex_{j,t} = The forecast capital expenditure of the Regulated Entity on assets in Asset Category j for Regulatory Year t as approved by the ERC for that Regulated Distribution System under Section 4.12.5 after applying the CWIP factor described in Section 4.8.12;

RegDepn_{cj,t} = The Regulatory Depreciation, for Regulatory Year t, of the forecast capital expenditure of the Regulated Entity on assets (excluding spares, land and easements) in Asset Category j (as approved by the ERC under Section 4.12.5 for that Regulated Distribution System) to the extent that such forecast capital expenditure relates to a Regulatory Year in the Third Regulatory Period which precedes Regulatory Year

t, such Regulatory Depreciation being calculated consistently with the methodology set out in Section 4.10.1.

4.9.3 For the purposes of this Section 4.9 and Section 4.10, assets are to be included in the same categories as specified in, or in accordance with, Section 4.8.8 or in smaller categories (Asset Categories $j = 1 \dots n$) such that each category includes similar assets with similar economic lives (such lives being calculated in accordance with Section 4.10.1).

4.10 Regulatory Depreciation

4.10.1 The Regulatory Depreciation, for Regulatory Year t, in respect of assets that are in an Asset Category j ($\text{RegDepn}_{j,t}$) is calculated on a straight line basis as follows:

(a) where Asset Category j does not comprise Transferred Subtransmission Assets - using either of the following methods depending on the available data:

$$\begin{aligned} \text{RegDepn}_{j,t} &= (\text{ORC}_{j,t} / \text{RegL}_{j,t}) + \text{Disposal}_{j,t} - \text{FISDA}_{j,t} \\ &\text{or} \quad (\text{ODRC}_{j,t} / \text{RemL}_{j,t}) + \text{Disposal}_{j,t} - \text{FISDA}_{j,t} \end{aligned}$$

Where:

$\text{ORC}_{j,t}$ = the optimized replacement cost, as at the commencement of Regulatory Year t, for the assets that are in Asset Category j;

$\text{RegL}_{j,t}$ = the Regulatory Life of Asset Category j as at the commencement of Regulatory Year t and is equal to the weighted average¹¹ economic life of the relevant assets as at the commencement of Regulatory Year t, where the economic life of an asset is taken to expire when the costs of maintenance and repair of that asset exceed the efficient replacement cost of it on a project comparison basis, using a forward looking discounted cash flow analysis, or as otherwise determined by the ERC. As a result of the report referred to in Section 4.10.3, $\text{RegL}_{j,t}$ may differ from the asset life used for financial reporting or taxation purposes;

$\text{Disposals}_{j,t}$ = the forecast receipts from the disposal, during Regulatory Year t, of assets in Asset Category j that are included in the regulatory asset base for that Regulated Distribution System (as defined in Section 4.8.8), as determined by the ERC as part of the Regulatory Reset Process for the Third Regulatory Period under Article VII. Such forecast receipts will be at the rolled-forward depreciated regulatory asset value for the relevant assets.

¹¹ Weighted by optimized replacement cost or by optimized depreciated replacement cost, depending on the information availability for asset age in the relevant Regulated Entity’s asset register systems.

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These receipts should not include the 5% residual value allocated to disposed assets previously used beyond their Regulatory Lives in terms of Section 4.8.16.

$FISDA_{j,t}$ = the forecast income (expressed in PhP) to a Regulated Entity that would arise during Regulatory Year t from the sale of disposed assets in Asset Category j, that were previously part of the rolled forward regulatory asset base for a Regulated Distribution System, as determined by the ERC as part of the Regulatory Reset Process for the Third Regulatory Period under Article VII, after deducting any forecast expenses associated with the sale but excluding the value at which the disposed assets were forecast to be removed from the rolled forward regulatory asset base;

$ODRC_{j,t}$ = the optimized depreciated replacement cost for the relevant assets as at the commencement of Regulatory Year t, calculated (on the basis of the application of straight line depreciation of the optimized replacement cost for those assets) by multiplying their optimized replacement cost by the weighted average Remaining Life of Asset Category j ($RemL_{j,t}$) and dividing that product by the Regulatory Life of Asset Category j ($RegL_{j,t}$);

$RemL_{j,t}$ = ($RegL_{j,t}$ - $Age_{j,t}$); and

$Age_{j,t}$ = the weighted average age of the relevant assets as at the commencement of Regulatory Year t; and

(b) where Asset Category j comprises Transferred Subtransmission Assets – using the following method:

$RegDepn_{j,t}$ = $RP_{j,t}/RemL_{j,t}$ + $Disposal_{j,t}$ – $FISDA_{j,t}$

Where:

$RP_{j,t}$ = the value of those assets, as at the commencement of Regulatory Year t, as determined in accordance with Section 4.8.13;

$RemL_{j,t}$ = ($RegL_{j,t}$ – $Age_{j,t}$);

$RegL_{j,t}$ = the Regulatory Life of Asset Category j as at the commencement of Regulatory Year t and is equal to the weighted average¹² economic life of those assets as at the commencement of Regulatory Year t, where the economic life of an asset is taken to

¹² Weighted by the value of the assets in Asset Category j, as determined in accordance with Section 4.8.12.

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expire when the costs of maintenance and repair of that asset exceed the efficient replacement cost of it on a project comparison basis, using a forward looking discounted cash flow analysis, or as otherwise determined by the ERC. As a result of the report referred to in Section 4.10.3, $RegL_{j,t}$ may differ from the asset life used for financial reporting or taxation purposes;

$Age_{j,t}$ = the weighted average of the relevant assets as at the commencement of Regulatory Year t;

$Disposal_{j,t}$ = the forecast receipts from the disposal, during Regulatory Year t, of assets in Asset Category j that are included as part of the Transferred Subtransmission Assets for a Regulated Distribution System, as determined by the ERC as part of the Regulatory Reset Process for the Third Regulatory Period under Article VII. Such forecast receipts will be at the rolled-forward depreciated regulatory asset value for the relevant assets. These receipts should not include the 5% residual value allocated to disposed assets previously used beyond their Regulatory Lives in terms of Section 4.8.13; and

$FISDA_{j,t}$ = the forecast income (expressed in PhP) to a Regulated Entity that would arise during Regulatory Year t from the sale of disposed assets in Asset Category j, that were previously part of the Transferred Subtransmission Assets for a Regulated Distribution System, as determined by the ERC as part of the Regulatory Reset Process for the Third Regulatory Period under Article VII, after deducting any forecast expenses associated with the sale but excluding the value at which the disposed assets were forecast to be removed from the rolled forward regulatory asset base.

4.10.2 The Regulatory Depreciation in respect of a Regulated Distribution System for Regulatory Year t in real terms ($RegDepn_t$) is calculated as follows:

$$RegDepn_t = (RegDepn_{o,t} + RegDepn_{c,t})$$

Where:

$RegDepn_{o,t}$ = Sum of $RegDepn_{oj,t}$ for Regulatory Year t for each Asset Category j, as defined in Section 4.9.2; and

$RegDepn_{c,t}$ = Sum of $RegDepn_{cj,t}$ for Regulatory Year t for each Asset Category j, as defined in Section 4.9.2.

4.10.3 For the purposes of this Section 4.10, the regulatory life that is attributable to an Asset Category j will be set in accordance with the schedules in the Valuation

Handbook described in Section 4.8.7, and such regulatory life must be the same for the same Asset Category for each Regulated Distribution System.

- 4.10.4 Assets remaining in use after reaching the end of their Regulatory Lives as described in Section 4.8.13 will not be subject to further depreciation.

4.11 Weighted Average Cost of Capital Determination

- 4.11.1 The purpose of calculating the weighted average cost of capital is to provide a cost of capital for regulatory purposes which can be applied to a Building Block cash flow model that generates a regulated revenue stream over a defined regulatory period for a Regulated Entity that provides Regulated Distribution Services in respect of a Regulated Distribution System.

- 4.11.2 For these purposes a classical weighted average cost of capital (WACC) is to be used as, in the ERC's view, it best balances the financial Building Blocks in Section 4.7.7 and the principles in Section 4.6.1. The ERC must retain a Regulatory Reset Expert or Regulatory Reset Experts pursuant to Article XIV for the purpose of assisting the ERC to determine the WACC during the Regulatory Reset Process for the Third Regulatory Period under Article VII. The WACC as so determined must be the same for all Regulated Entities and all Regulated Distribution Systems in an Entry Group. However, since the WACC will be determined for each Entry Group, subject to Section 4.11.13 there may be differences in the figures used for different Entry Groups.

- 4.11.3 The WACC (expressed in decimal, as opposed to percentage, terms) is to be calculated as follows:

$$\text{WACC} = [r_e \times E / V] + [r_d \times D / V]$$

Where:

r_e = the cost of equity and is calculated in accordance with Section 4.11.4;

r_d = the cost of debt and is calculated in accordance with Section 4.11.10;

E = the amount of equity funding assumed for regulatory purposes in the capital structure of a Regulated Entity, being 60% of V for the Third Regulatory Period;

D = the amount of debt funding assumed for regulatory purposes in the capital structure of a Regulated Entity, being 40% of V for the Third Regulatory Period; and

V = E + D.

- 4.11.4 The cost of equity (r_e), expressed in decimal terms, is calculated as follows:

$$r_e = r_f + \text{Beta}_e \times (r_m - r_f)$$

Where:

r_f = the risk-free rate within the Philippines, expressed in decimal terms, as determined in accordance with Section 4.11.5;

Beta_e = the industry average Equity Beta for electricity distribution businesses in the Philippines (excluding electricity distribution businesses conducted by Electric Cooperatives) as determined by the ERC for regulatory purposes in accordance with Sections 4.11.6 to 4.11.8; and

(r_m - r_f) = the Market Risk Premium (MRP), expressed in decimal terms, adopted by the ERC as specified in Section 4.11.9.

4.11.5 The best approximation of a risk-free rate is generally the yield on the longest dated government borrowing instrument, usually a Treasury Bill or equivalent. In the USA this is either the 10 year government bond or the 30 year government bond. Some regulators in overseas jurisdictions prefer to use the yield for a government bond with the same duration as the relevant regulatory period. In the Philippines, the longest dated government bond is a 10 year Treasury Bill. The ERC will use the yield on such Treasury Bills as traded in the Philippines' secondary bond markets¹³ as the risk-free rate in the Philippines unless there is insufficient liquidity, or the time to maturity is too short, for that market yield to be a satisfactory estimate of the risk-free rate within the Philippines. If the latter is the case, the ERC will determine the risk-free rate only after considering alternative overseas data sources and the related adjustment calculations which lead to the derivation of a viable proxy for the risk-free rate within the Philippines.

4.11.6 The Equity Beta of a business is a measure of the systematic or non-diversifiable risk of that business in comparison to the risk of the equity market as a whole. The Equity Beta is a function of the covariance of the volatility of the returns to the business in the active market place compared to the volatility of average market returns: it is higher than 1.0 for businesses which exhibit higher share price volatility than the market average, and lower than 1.0 for those with share price volatility that is less than the market average. The Equity Beta is difficult to measure accurately for an individual business due to low sample size of data and the volatile nature of returns (the circumstances of businesses change over time). The industry average Equity Beta for electricity distribution businesses in the Philippines (excluding electricity distribution businesses conducted by Electric Cooperatives) is as determined by the ERC using such valid data as is available and by reference to comparable overseas electricity businesses.

4.11.7 For the Third Regulatory Period, the ERC will determine the industry average Equity Beta for electricity distribution businesses in the Philippines (excluding electricity distribution businesses conducted by Electric Cooperatives) (Beta_e) in accordance with the following formula:

$$\text{Beta}_e = \text{Beta}_a \times [1 + (D / E)]$$

Where:

Beta_a = the industry average Asset Beta for electricity distribution businesses in the Philippines (excluding electricity

¹³ A secondary bond market or equivalent must be used so that sufficient liquidity (i.e. volume of trading) in the market allows the yields to represent a market price for the bonds. The yield on direct government issues to the banks does not have sufficient liquidity for regulatory purposes.

distribution businesses conducted by Electric Cooperatives) as determined by the ERC in accordance with Section 4.11.8, based on submissions made to the ERC as part of the Regulatory Reset Process for the Third Regulatory Period under Article VII;

D = as defined in Section 4.11.3; and

E = as defined in Section 4.11.3.

4.11.8 The Asset Beta for a business would normally be derived from an examination of the Equity Betas observed in the local Philippine equity market place. However, because such market information may not be readily available and may suffer from either low trading volumes or insufficient data points for statistical veracity, the ERC will determine an industry average Asset Beta for electricity distribution businesses in the Philippines (excluding electricity distribution businesses conducted by Electric Cooperatives) and will do so on the basis of the Asset Betas of comparable overseas electricity businesses. The ERC recognizes that such comparison is difficult due to the different circumstances which apply in other jurisdictions as a result of, for example, differences in geographic and climatic conditions, market structures, business structures and other matters which may affect equity return volatility. Accordingly, for this purpose, the ERC will primarily have regard to the Asset Betas of electricity distribution businesses in overseas countries of a similar nature to the Philippines but, where issues relating to market liquidity, data availability or data consistency are of concern, it will also have regard to the Asset Betas of integrated electricity businesses or of electricity transmission or distribution businesses in developed countries, with an emphasis on those businesses subject to incentive based and/or competitive regulatory regimes. The ERC will calculate the Asset Beta of each such business ($Beta_a$) in accordance with the following formula:

$$Beta_a = Beta_e / [1 + (1 - T_e) \times D_m / E_m]$$

Where:

$Beta_e$ = the equity beta of the relevant overseas business as measured empirically by an independent international ratings agency or financial market reporting company such as Bloomberg or a similar service;

T_e = the effective corporate tax rate for that business as ascertained from information provided by an independent international ratings agency or financial market reporting company or, in the absence of such data, the corporate income tax rate for the country in which the relevant business is located (in either case expressed in decimal terms);

D_m = the amount of debt funding in the capital structure of that business as ascertained from information provided by an independent international ratings agency or financial market reporting company; and

E_m = the amount of equity funding in the capital structure of that business as ascertained from information provided by an

independent international ratings agency or financial market reporting company.

In considering overseas comparisons to more developed economies, the ERC will give due regard to the fact that the Philippines is a developing economy and that, as such, the systemic risk it presents to investors is at the higher end of the range observed overseas, especially among developed economies. The asset beta adopted for the WACC setting will therefore be adapted from the observed values by a factor of 1.25, to make provision for this higher risk.

4.11.9 The Market Risk Premium (MRP) is a measure of the risk associated with holding a portfolio of equity market assets rather than a portfolio of long-dated government bonds. The premium effectively measures the difference between the long-term average return to investors in the equity market of the Philippines (r_m) and the risk-free rate within the Philippines (r_f). Due to the smaller size, and potential lower liquidity, of the publicly traded equity market in the Philippines, the absence of history on long-term government bonds with reasonable liquidity and the absence of a reasonably long time-series of market data, the ERC will adopt, for the Third Regulatory Period, an MRP of 0.06.

4.11.10 The cost of debt (r_d), expressed in decimal terms, is calculated as follows:

$$r_d = r_f + DM$$

Where:

r_f = the risk-free rate within the Philippines, expressed in decimal and nominal terms, as determined in accordance with Section 4.11.5; and

DM = the industry average debt margin (or premium) within the Philippines (expressed in decimal and nominal terms) as determined by the ERC, which conceptually represents the margin above the risk-free rate within the Philippines that is requested by debt providers for providing funds to electricity distribution businesses in the Philippines (other than electricity distribution businesses conducted by Electric Cooperatives) to the extent such debt arrangements are representative of arms length negotiated rates in liquid markets and are financially efficient.

In the Philippines, there may be an expectation that the debt margin for a regulated electricity distribution business will be higher than in more developed countries. The size and availability of debt funding sources from within the Philippines may be limited due to either bond market size or bank lending covenants. As a result access to the required debt levels may require the inclusion of a “guarantee” premium of one form or another in the cost of debt, which is above the debt margin seen in overseas markets. This margin might be for either a peso guarantee (where debt funds are sought in the Philippines and are guaranteed by an offshore bank) or a partial risk guarantee from the World Bank or similar international funding agency (where debt funds are sought outside the Philippines). The ERC must not allow the risks associated with the provision of debt finance to be double counted or over compensated

within the industry average debt margin, but the industry average debt margin must reflect a realistic market outcome at the time it is determined. The ERC will determine the industry average debt margin for the purposes of calculating the cost of debt only after considering alternative sources of debt funds which may be appropriate in the context of funding an electricity distribution business within the Philippines, such consideration to occur during the Regulatory Reset Process for the Third Regulatory Period under Article VII.

- 4.11.11 During the Regulatory Reset Process for the Third Regulatory Period under Article VII, the ERC will give each Regulated Entity and other interested parties the opportunity to make written submissions to the ERC on the method and data sources which the ERC should rely upon in its determination of the risk-free rate within the Philippines, the industry average Equity Beta, the industry average Asset Beta and the cost of debt for the purposes of calculating WACC.
- 4.11.12 Once these Rules have come into effect, the formula for calculating WACC and its components as set out in this Section 4.11 must not be altered by the ERC for the Third Regulatory Period except as the result of a consultative process in which all Regulated Entities and other interested parties have opportunity to participate and after due consideration of submissions received as a result of such consultation. The ERC may however from time to time amend the manner in which it determines the underlying parameters on which its calculation of the WACC is based.
- 4.11.13 At each Entry Point the ERC will determine an updated value for the WACC that will apply to the new Entry Group. If this WACC differs by more than 10% from the WACC currently applied to a previous Entry Group, the WACC for this previous Entry Group will be amended in accordance with the latest determination of the ERC. That will give rise to a re-opening event as described in Article XII, Section 12.6.
- 4.11.14 The ERC recognizes that determining the underlying parameters on which the WACC is based, is subject to a significant degree of uncertainty. To address this, the ERC will consider a range of figures within which the regulatory WACC can be determined with an appropriate degree of certainty. Given the developing nature of the regulatory environment, especially performance-based regulation, in the Philippines and the fact that many of the regulatory decisions may still be subject to challenges and delays while the processes are embedded, Regulated Entities face an unusual degree of regulatory uncertainty. This affects the risk profile of these Regulated Entities and the commensurate rate of return to investors in electricity distribution infrastructure. To compensate for this uncertainty, the ERC will select the WACC from the 75th percentile of the suggested range of values (rather than using the average from the range).
- 4.11.15 To ensure equity between Regulated Entities, the ERC will at the start of the Third Regulatory Period for each Entry Group, calculate the effective WACC that applies to that Entry Group over the Third Regulatory Period. It will also calculate the equivalent WACC that should have applied over the Third Regulatory Period for that Entry Group, had the actual WACC as determined at various Entry Points during the Third Regulatory Period been used. These calculations will take into account that dates at which new WACC values were calculated and the periods that these values would have applied to an Entry Group. The WACC between entry points will be assumed to be constant, and the resulting equivalent WACC calculation will be

weighted according to the duration that values derived at each reset would have applied (and not according to the actual capital investment programs of a Regulated Entity).

- 4.11.16 The difference between the actual return on capital earned by a Regulated Entity over the Third Regulatory Period, and the value which would have resulted had the newly derived equivalent WACC Period applied for the Third Regulatory Period, will be calculated. This difference, unadjusted for the time value of money, will be added to or subtracted from the allowed revenue requirement for that Regulated Entity for the Third Regulatory Period.

4.12 Capital Expenditure Forecast

- 4.12.1 During the Regulatory Reset Process for the Third Regulatory Period under Article VII, each Regulated Entity must provide the ERC with its forward forecasts of its proposed annual capital expenditure, for each Regulated Distribution System that is operated by it, for each Regulatory Year in the Third Regulatory Period. This capital expenditure program must separately identify each capital expenditure project in respect of which the forecast capital expenditure in any Regulatory Year or subsequent Years during or after the Third Regulatory Period is greater than PhP 30 million or 20% of total capital expenditure forecasted for that Regulatory Year, whichever is lower. For both these separately identified projects and the remaining forecasted capital expenditure, the forecasts must each be broken down into the asset categories specified in, or in accordance with, Section 4.8.5. The capital expenditure program will be subject to review by a Regulatory Reset Expert or Regulatory Reset Experts under Section 4.12.4.

- 4.12.2 For each of the capital expenditure projects which are separately identified in accordance with Section 4.12.1, the capital expenditure program must be accompanied by:

- (a) a description of the project;
- (b) the reason for the ranking of the project relative to other projects in terms of its proposed commissioning date;
- (c) the impact the project is expected to have on those measures of the performance of the relevant Regulated Distribution System which are determined by the ERC under Article VIII;
- (d) a classification of the project into the following categories:
 - renewal related (identifying why the assets need replacing, what remaining asset value is sought to be written off, if any, and the potential disposal value of the replaced assets); or
 - refurbishment related (identifying the increase in operational life expected from the refurbishment, if any); or
 - growth-related or new assets (identifying which assets are for shared network infrastructure and which are for new connections); and

- (e) a division of the forecast capital expenditure for that project into the forecast annual capital expenditure on that project, with a further division into directly attributable expenditures and allocated overheads.

To avoid confusion over what constitutes load growth, renewal or refurbishment related projects, the following should be noted.

- (i) Projects undertaken to provide Regulated Distribution Services to new Customers or to increase the capacity of Regulated Distribution Systems in order to meet growing demands for Regulated Distribution Services from existing Customers, should be classed as load growth projects.
- (ii) Projects undertaken to renew assets because they can no longer meet growing demands should be classed as load growth projects.
- (iii) Renewal projects are those that replace existing assets due to their deteriorating condition, when the anticipated economic cost of operating, refurbishing and maintaining these assets exceed that to renew them.
- (iv) Renewal projects can also be to replace assets due to technological obsolescence.
- (v) There is often a significant degree of overlap between maintenance and refurbishment projects. In general, maintenance works are defined as those works required to ensure that an asset performs its designated function for its full standard asset life. Refurbishment projects on the other hand, are those that are used to increase the serviceability of assets to beyond their normal standard asset lives. Expenses incurred for maintenance activities should not be capitalized.
- (vi) Refurbishment projects often involve at least a degree of asset replacement, which may give rise to some ambiguity. Such projects should be classed in accordance with their underlying activities that constitute the largest part of the project value.

4.12.3 For the remaining forecast capital expenditure which is not allocated to separately identified capital expenditure projects in accordance with Section 4.12.1, the capital expenditure program must be accompanied by a justification, against each of the asset categories specified in, or in accordance with, Section 4.8.5, as to why the forecasted expenditures are necessary and are of reasonable magnitude, and must be categorized as follows:

- (a) renewal-related;
- (b) refurbishment-related; or
- (c) growth-related or new assets;

as defined in Section 4.12.2(d).

4.12.4 The ERC must review both the capital expenditure program for a Regulated Distribution System and the accompanying documentation to determine:

- (a) whether the capital expenditure program has been represented fairly such that all related capital expenditure is grouped together into the one project and has not been sub-divided to place it below the individual project reporting threshold in

Section 4.12.1, is based upon the best available prices (adjusted to PhP) obtainable from international markets, is reasonably efficient from a design and implementation point of view, is likely to support the forecast growth in connections, co-incident peak demand and energy delivered and is sufficient to allow the relevant Regulated Entity to achieve or exceed the applicable target levels of performance specified under Article VIII; and

- (b) whether the PhP/\$US exchange rate and CPI forecasts referred to in Section 4.12.6 are reasonable.

For this purpose the ERC may retain a Regulatory Reset Expert or Regulatory Reset Experts pursuant to Article XIV to conduct the review on its own or in cooperation with ERC staff, or the ERC may decide to conduct the review internally.

- 4.12.5 If the ERC has opted to use a Regulatory Reset Expert or Regulatory Reset Experts as referred to in Section 4.12.4, once they have presented their written reports to the ERC, the ERC must decide, following a consideration of the recommendations of the Regulatory Reset Expert or Regulatory Reset Experts as provided in their written reports:

- (a) whether the relevant capital expenditure program is based upon the best available prices (adjusted to PhP) obtainable from international markets, is reasonably efficient, is likely to support the forecast growth in connections, co-incident peak demand and energy delivered and is sufficient to allow the relevant Regulated Entity to achieve or exceed the applicable target levels of performance specified under Article VIII; and
- (b) whether the PhP/\$US exchange rate and CPI forecasts referred to in Section 4.12.6 are reasonable.

If the ERC decides these conditions have been met it must approve:

- (c) the capital expenditure program proposed by the Regulated Entity; and
- (d) the PhP/\$US exchange rate and CPI forecasts used by the Regulated Entity for that purpose.

If the ERC decides these conditions have not been met it must, after consulting with the Regulated Entity, approve such program or forecasts with such amendments as it considers necessary for those conditions to be met. Such consultation can be conducted through inviting submissions on the ERC's draft determination on the price control arrangements for the Third Regulatory Period. These submissions will be considered in preparing the final determination on the price control arrangements.

- 4.12.6 The capital expenditure forecasts provided by a Regulated Entity as part of a capital expenditure program referred to in Section 4.12.1 must be provided in real and nominal terms and must be supported by detailed documentation which clearly and comprehensively substantiates those forecasts, including details of the PhP/\$US exchange rate and CPI forecasts, for each Regulatory Year, which have been used by the Regulated Entity to generate those forecasts. These exchange rate and CPI forecasts must be consistent with those used for forecasting operating and maintenance expenditure, as described in Section 4.13.6.

- 4.12.7 The ERC must determine the capital expenditure forecast to be included in the Building Block analysis based on consideration of the information available to it including any reports of a Regulatory Reset Expert or Regulatory Reset Experts referred to in Section 4.12.4. Unless contradictory evidence exists for particular projects, expenditure forecasts must be based on the standard replacement rates contained in the Valuation Handbook, adapted by the multiplier ranges provided, as appropriate.
- 4.12.8 During the Regulatory Reset Process for the Third Regulatory Period under Article VII, each Regulated Entity has to provide historical records of capital expenditure on Distribution System Assets and Non-system Assets related to the Distribution System for each of the four Regulatory Years up to the year ending on June 30, 2010, and the budgeted expenditure for Regulatory Year 2011. The budgets have to be based on the Regulated Entities' best estimate at the time. These expenditure records and budgets have to be broken down into the categories described in Section 4.8.5. Projects completed over this period, with individual items with values exceeding PhP30 million or 20% of the total annual capital expenditure separately identified.

4.13 Operating and Maintenance Expenditure

- 4.13.1 During the Regulatory Reset Process for the Third Regulatory Period under Article VII, each Regulated Entity must provide the ERC with:

- (a) its historical operating and maintenance expenditure, in relation to each Regulated Distribution System that is operated by it, for each of the four Regulatory Years up to the year ending on June 30, 2010, and the budgeted expenditure for Regulatory Year 2011; and
- (b) its forward forecasts of its proposed annual operating and maintenance expenditure, in relation to each such Regulated Distribution System, for each Regulatory Year in the Third Regulatory Period.

Such annual historical and forecast operating and maintenance expenditure must separately identify operating and maintenance expenditure grouped into the following categories and sub-categories in relation to the relevant Regulated Distribution System:

- (c) Regulated Distribution Services expenses - operation
 - (i) Operation supervision and engineering
 - (ii) Contractor services
 - (iii) Load Dispatching
 - (iv) Structures
 - (v) Substations
 - (vi) Overhead lines & devices
 - (vii) Underground cables & devices
 - (viii) Street Lighting and Signal System (non-roadway and roadways)
 - (ix) Metering (distribution network related including metering related to monitoring and managing system losses)
 - (x) Rents
 - (xi) Information technology (distribution network related)

- (xii) Miscellaneous

- (d) Regulated Distribution Services expenses – maintenance
 - (i) Maintenance supervision & engineering
 - (ii) Contractor services
 - (iii) Structures
 - (iv) Substation equipment
 - (v) Overhead lines & devices
 - (vi) Underground cables & devices
 - (vii) Street Lighting and Signal System (non-roadway and roadways)
 - (viii) Distribution transformers
 - (ix) Information technology (distribution network related)
 - (x) Metering (distribution network related including metering related to monitoring and managing system losses)
 - (xi) Miscellaneous

- (e) Regulated Distribution Services expenses – Administrative & general
 - (i) Company management costs
 - (ii) Administrative and General Salaries
 - (iii) Office Supplies and Expenses
 - (iv) Information technology (admin & general)
 - (v) Outside Services Employed
 - (vi) Property Insurance
 - (vii) Injuries and Damages
 - (viii) Employee Pension and Benefits
 - (ix) Regulatory liaison and compliance
 - (x) Rents
 - (xi) Maintenance of Office and General Plant
 - (xii) Officers Allowances and Benefits
 - (xiii) Travel
 - (xiv) Training
 - (xv) Water and electricity
 - (xvi) Miscellaneous
 - (xvii) WESM compliance – market fees¹⁴
 - Registration fees

¹⁴ Only to the extent that these costs apply to Regulated Distribution Services

- Metering fees
 - Billing and settlement fees
 - Administration fees
 - Costs for the PEM Board, committees & working groups
 - Market Management Software and upgrades costs recovery
 - WESM – provision and maintenance of security¹⁵
- (f) Distribution Connection Services - Operation
- (i) Operation supervision and engineering
 - (ii) Contractor services
 - (iii) Structures
 - (iv) Substations
 - (v) Overhead lines & devices
 - (vi) Underground cables & devices
 - (vii) Consumer installations
 - (viii) Information technology (distribution connection services related)
 - (ix) Miscellaneous
- (g) Distribution Connection Services – Maintenance
- (i) Maintenance supervision & engineering
 - (ii) Contractor services
 - (iii) Structures
 - (iv) Substations
 - (v) Overhead lines & devices
 - (vi) Underground cables & devices
 - (vii) Distribution transformers
 - (viii) Information technology (distribution network related)
 - (ix) Miscellaneous
- (h) Distribution Connection Services – Administrative & general
- (i) Administrative and General Salaries
 - (ii) Office Supplies and Expenses
 - (iii) Information technology (admin & general)
 - (iv) Outside Services Employed
 - (v) Property Insurance

¹⁵ Distribution Utilities in Luzon are mandated to source at least 10% of their power requirements from the Spot Market. Similar targets for Visayas may follow in future.

- (vi) Injuries and Damages
 - (vii) Employee Pension and Benefits
 - (viii) Regulatory liaison and compliance
 - (ix) Rents
 - (x) Maintenance of Office and General Plant
 - (xi) Officers Allowances and Benefits
 - (xii) Travel
 - (xiii) Training
 - (xiv) Water and electricity
- (i) Regulated Retail Services
- (i) Administration and management of the provision of regulated retail services
 - (ii) Planning, installation and maintenance of consumer metering installations
 - (iii) Consumer Meter Reading Expenses
 - (iv) Information technology (retail related)
 - (v) Consumer Records, Billing and Collection Expenses
 - (vi) Bad debts
 - (vii) Informational and Instructional Advertising Expenses
 - (viii) Energy trading expenses (excluding energy purchases)
 - (ix) Rents
 - (x) Water and electricity¹⁶
 - (xi) Miscellaneous Consumer Services Expenses
 - (xii) Regulatory liaison and Compliance
- (j) Any other categories or sub-categories specified by the ERC.
- (k) The regulatory liaison and compliance cost category included above is for all reasonable costs associated with complying with applicable ERC rules and regulations, but does not include the costs of any Regulatory Reset Expert that the Regulated Entity is required to bear under Section 14.4.1.

Where Regulated Entities engage in alternative business activities outside the operation of their Regulated Distribution Systems and incur operating and maintenance expenditure for services that are shared between these alternative business activities and the Regulated Distribution Services, Regulated Entities must provide full details of the magnitude of these costs and the manner in which these costs are allocated between the alternative business activities and the Regulated Distribution Services. Such alternative business activities can include related business activities as noted in Section 4.3.4.

¹⁶ This is for electricity consumption incurred in providing Regulated Retail Services, not bulk energy purchases.

4.13.2 During the Regulatory Reset Process for the Third Regulatory Period under Article VII, each Regulated Entity must also provide the ERC with:

- (a) a summary of its historical payments of taxes, levies and duties (other than corporate income tax), incurred in relation to each Regulated Distribution System that is operated by it, for each of the four Regulatory Years up to the year ending on June 30, 2010, and the budgeted expenditure for Regulatory Year 2011; and
- (b) its forward forecasts of its expected payments of taxes, levies and duties (other than corporate income tax), to be incurred in relation to each such Regulated Distribution System, for each Regulatory Year in the Third Regulatory Period.

The cost that a Regulated Entity is required to bear for Regulatory Reset Experts, as described in Article XIV, is to be included as a levy in these summaries or forecasts.

4.13.3 The annual operating and maintenance expenditure forecasts referred to in Section 4.13.1 must be accompanied by a justification against each of the expenditure categories referred to in Section 4.13.1 as to why the forecast expenditures are necessary and are of reasonable magnitude (such forecasts could, for example, be supported by benchmarks against overseas electricity distribution businesses). The written justification must also demonstrate improvements in operational efficiency and productivity over the Third Regulatory Period. For these purposes, benchmarks against operational parameters such as staff numbers, energy throughput, service performance or other measures may be used to justify the relevant expenditures.

4.13.4 The ERC must review both the operating and maintenance expenditure forecasts as well as the forecast expenditure for taxes, levies and duties (other than corporate income taxes) in relation to a Regulated Distribution System and the accompanying documentation to determine:

- (a) whether the forecast expenditure is reasonably efficient, is likely to support the forecast growth in connections, co-incident peak demand and energy delivered and is sufficient to allow the relevant Regulated Entity to achieve or exceed the applicable target levels of performance specified under Article VIII;
- (b) whether the forecasts for bad debts reflect a responsible approach to collections and are consistent with a reasonable strategy for improving collections; and
- (c) whether the PhP/\$US exchange rate and CPI forecasts referred to in Section 4.13.6 are reasonable.

For this purpose the ERC may retain a Regulatory Reset Expert or Regulatory Reset Experts pursuant to Article XIV to conduct the review in isolation or in cooperation with ERC staff, or the ERC may decide to conduct the review internally.

4.13.5 If the ERC has opted to use a Regulatory Reset Expert or Regulatory Reset Experts as referred to in Section 4.13.4 for the review, once they have presented their written reports to the ERC, the ERC must decide, following a consideration of the recommendations of the Regulatory Reset Expert or Regulatory Reset Experts as provided in their written reports:

- (a) whether the relevant forecast operating and maintenance expenditure is reasonably efficient, is likely to support the forecast growth in connections, co-incident peak demand and energy delivered and is sufficient to allow the relevant

Regulated Entity to achieve or exceed the applicable target levels of performance specified under Article VIII;

- (b) whether the forecasts for bad debts reflect a responsible approach to collections and are consistent with a reasonable strategy for improving collections; and
- (c) whether the PhP/\$US exchange rate and CPI forecasts referred to in Section 4.13.6 are reasonable.

If the ERC decides these conditions have been met it must approve:

- (d) the forecast operating and maintenance expenditure (and forecast payments of taxes, levies and duties referred to in Section 4.13.2 (b)) proposed by the Regulated Entity; and
- (e) the PhP/\$US exchange rate and CPI forecasts used by the Regulated Entity for that purpose.

If the ERC decides these conditions have not been met it must, after consulting with the Regulated Entity, approve such forecasts with such amendments as it considers necessary for those conditions to be met.

4.13.6 The operating and maintenance expenditure forecasts, and forecast payments of taxes, levies and duties referred to in Section 4.13.2 (b), provided by a Regulated Entity must be provided in real and nominal terms and must be supported by detailed documentation which clearly and comprehensively substantiates those forecasts, including details of the PhP/\$US exchange rate and CPI forecasts, for each Regulatory Year, which have been used by the Regulated Entity to generate those forecasts. These exchange rate and CPI forecasts must be consistent with those used for forecasting capital expenditure, as described in Section 4.12.6.

4.13.7 The ERC must determine the operating and maintenance expenditure forecasts to be included in the Building Block analysis based on consideration of the information available to it including any reports of a Regulatory Reset Expert or Regulatory Reset Experts referred to in Section 4.13.4.

4.14 Calculation of Corporate Income Tax

4.14.1 The estimated corporate income tax payable by a Regulated Entity in respect of a Regulated Distribution System in Regulatory Year t ($Tax_{p,t}$) must be calculated by the ERC in accordance with the following formula:

$$Tax_{p,t} = NTIncome_{t-1} \times T_c$$

Where:

$NTIncome_{t-1}$ = the Net Taxable Income of the Regulated Entity for Regulatory Year t-1 as determined by the ERC on the basis of the methodology for its determination as set out in Section 4.14.2; and

T_c = the corporate tax rate applicable in respect of the Regulated Entity pursuant to the laws of the Philippines.

4.14.2 For the purposes of Section 4.14.1, $NTIncome_{t-1}$ is calculated as the greater of zero and:

$$TIncome_{t-1} + AT_{t-2}$$

Where:

$TIncome_{t-1}$ = the taxable income of the Regulated Entity for Regulatory Year t-1 as calculated on the basis of the methodology for its determination set out in Section 4.14.3; and

AT_{t-2} = the net tax losses carried forward at the end of the Regulatory Year in the Third Regulatory Period which precedes Regulatory Year t-1,

where the net tax losses:

- (i) arise from the provision of Regulated Distribution Services in respect of the relevant Regulated Distribution System by the Regulated Entity;
- (ii) are calculated from the start of the last year of the First Regulatory Period to the end of the Regulatory Year in the Third Regulatory Period which precedes Regulatory Year t-1;
- (iii) carried forward at the end of any Regulatory Year in the period covered are calculated as the sum of the tax losses carried forward into that Regulatory Year and the taxable income or tax loss for that Regulatory Year; and
- (iv) only exist where it is a negative amount, with positive amounts resulting in a zero net tax loss carried forward.

For these purposes, taxable income will be treated as a positive amount and tax losses will be treated as a negative amount.

4.14.3 For the purposes of Section 4.14.2, $TIncome_{t-1}$ is calculated as:

$$TIncome_{t-1} = (SMAP_{t-1} \times Q_{t-1}) - Opex_{t-1} - HCDepn_{t-1} - RegInt_{t-1}$$

Where:

In the First Regulatory Year,

$SMAP_{t-1}$ = MAP_{t-1} as determined during for the last Regulatory Year of the Second Regulatory Period;

In the subsequent Regulatory Years,

$SMAP_{t-1}$ = the Smoothed Maximum Annual Price cap (expressed in PhP/kWh) that the Regulated Entity is permitted to charge for the provision by it, during Regulatory Year t-1, of Regulated Distribution Services in respect of that Regulated Distribution System, as calculated in accordance with Section 4.15.4;

Q_{t-1} = the total amount of energy (expressed in kWh) that is forecasted to be delivered through the relevant Regulated Distribution System, during Regulatory Year t-1, to Connection Points in respect of that Regulated Distribution System, such amount of energy being forecasted in a manner that is approved for this purpose by the ERC;

$Opex_{t-1}$ = the nominal operating and maintenance expenditure, and the payments of taxes, levies and duties (other than corporate income taxes), which are forecasted to be incurred in relation to

the relevant Regulated Distribution System for Regulatory Year t-1 and which are approved by the ERC in accordance with Section 4.13;

HCDepn_{t-1} = the regulatory historical cost depreciation of the Regulatory Asset Base for the relevant Regulated Distribution System for Regulatory Year t-1 (see Sections 4.8.11 and 4.9) in real terms as determined by the ERC on the basis of the methodology for the determination of RegDepn_{t-1} as set out in Sections 4.10.1 and 4.10.2, with the substitution, in the depreciation calculation, of historical cost valuations (as per Philippine accounting practice) for replacement cost valuations or valuations in accordance with Section 4.8.13 (as the case may be); and

RegInt_{t-1} = the interest payments on outstanding debt for Regulatory Year t-1 as determined by the ERC in accordance with the following formula:

$$\text{RegInt}_{t-1} = (\text{RAB}_{t-1} - \text{AORL}_{t-1}) \times D / V \times r_d$$

Where:

RAB_{t-1} = the Regulatory Asset Base for the relevant Regulated Distribution System for Regulatory Year t-1 in real terms as determined under Section 4.9.1;

$$\text{AORL}_{t-1} = (\text{AORL}_{o,t-1} + \text{AORL}_{c,t-1}) / 2$$

Where

AORL_{o,t-1} = the opening 5% residual value of assets that are remaining in service beyond their regulatory lives for Regulatory Year t-1 in real terms as determined under Section 4.9.1; and

AORL_{c,t-1} = the closing 5% residual value of assets that are remaining in service beyond their regulatory lives for Regulatory Year t-1 in real terms as determined under Section 4.9.1;

D and V are as defined in Section 4.11.3; and

r_d = the cost of debt as calculated in accordance with Section 4.11.10.

4.14.4 Notwithstanding the actual corporate income tax payable by Regulated Entities, for the Third Regulatory Period, the value of the corporate income tax (Tax_{p,t} as defined in Section 4.14.1) will be set to zero for the purposes of determining the allowed revenue requirement in Section 4.7.7.

4.15 Smoothing

4.15.1 As a result of the Building Block approach, it is unlikely that there will be a linear increase, for each Regulatory Year in the Third Regulatory Period, in the allowed annual revenue requirement for a Regulated Distribution System. Accordingly, so as to reduce the likelihood of price shocks to Customers of that Regulated Distribution System and of revenue shocks to the Regulated Entity that operates that Regulated

Distribution System, the ERC will smooth the Maximum Annual Price caps for that Regulated Distribution System for each Regulatory Year in the Third Regulatory Period in accordance with this Section 4.15. Such smoothed Maximum Annual Price caps will incorporate a recovery of efficiency savings in costs. It may also include under- or over-recoveries carried over from the Second Regulatory Period, where the full correction for such recoveries in MAP₂₀₁₂ is deemed by the ERC to represent an excessive step-change over the MAP₂₀₁₁ (determined for the last year of the Second Regulatory Period). In addition, the smoothed Maximum Annual Price caps may also include a recovery of regulatory interventions made by the ERC in the Allowed Revenue Requirement of a Regulated Entity during earlier Regulatory Periods.

4.15.2 The first step is to calculate the present value of the allowed annual revenue resulting from the maximum average prices that the relevant Regulated Entity is permitted to charge for the provision by it, during each of the Regulatory Years in the Third Regulatory Period, of Regulated Distribution Services in respect of the relevant Regulated Distribution System (PVR₂₀₁₁), such amount being calculated as follows:

$$\begin{aligned} \text{PVR}_{2011} = & (\text{ARR}_{2012}) / (1 + \text{WACC}) + \\ & (\text{ARR}_{2013}) / (1 + \text{WACC})^2 + \\ & (\text{ARR}_{2014}) / (1 + \text{WACC})^3 + \\ & (\text{ARR}_{2015}) / (1 + \text{WACC})^4 \end{aligned}$$

where:

ARR_t = the allowed annual revenue requirement for that Regulated Distribution System for Regulatory Year t (t = 2012 to 2015) as calculated in accordance with Section 4.7.7; and

WACC = the classical weighted average cost of capital as determined by the ERC in accordance with Section 4.11.

4.15.3 The second step is to calculate the Efficiency Factor (X) in respect of the relevant Regulated Distribution System for the Third Regulatory Period from the solution of the following equation (where only X is unknown) using the results of the calculation in Section 4.15.2:

$$\begin{aligned} \text{PVR}_{2011} = & [\text{MAP}_{2011} - P_o] \times \\ & [\{ (1 + \text{Inflation}_{2012} - X) \times \text{FQ}_{2012} / (1 + \text{WACC}) \} + \\ & \{ (1 + \text{Inflation}_{2012} - X) \times (1 + \text{Inflation}_{2013} - X) \times \text{FQ}_{2013} / (1 + \text{WACC})^2 \} + \\ & \{ (1 + \text{Inflation}_{2012} - X) \times (1 + \text{Inflation}_{2013} - X) \times (1 + \text{Inflation}_{2014} - X) \times \\ & \text{FQ}_{2014} / (1 + \text{WACC})^3 \} + \\ & \{ (1 + \text{Inflation}_{2012} - X) \times (1 + \text{Inflation}_{2013} - X) \times (1 + \text{Inflation}_{2014} - X) \times (1 + \\ & \text{Inflation}_{2015} - X) \times \text{FQ}_{2015} / (1 + \text{WACC})^4 \}] \end{aligned}$$

where:

PVR₂₀₁₁ is as calculated pursuant to Section 4.15.2;

MAP₂₀₁₁ = The MAP determined by the ERC for the last year of the Second Regulatory Period;

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FQ_t = The total amount of energy (expressed in kWh) that is forecasted to be delivered through the relevant Regulated Distribution System, during Regulatory Year t (t = 2012 to 2015), to Distribution Connection Points in respect of that Regulated Distribution System, such amount of energy being forecasted in a manner that is approved for this purpose by the ERC;

P_0 is such amount (expressed in PhP/kWh) as the ERC determines in respect of that Regulated Distribution System to take into account a balance between windfall gains and windfall losses in revenue resulting from exogenous factors, and to assist with the reduction of price shocks during the transition from pre-PBR distribution prices to the Third Regulatory Period, provided only that such amount must be:

- less than or equal to $MAP_{2011} - [(ARR_{2012} / FQ_{2012}) / (1 + WACC)]$ (but must not be a negative amount)

where $MAP_{2011} \geq [(ARR_{2012} / FQ_{2012}) / (1 + WACC)]$

(\geq meaning greater than or equal to); or

- greater than or equal to $MAP_{2011} - [(ARR_{2012} / FQ_{2012}) / (1 + WACC)]$ (but must not be a positive amount)

where $MAP_{2011} \leq [(ARR_{2012} / FQ_{2012}) / (1 + WACC)]$

(\leq meaning less than or equal to);

$WACC$ = the classical weighted average cost of capital as determined by the ERC in accordance with Section 4.11; and

$Inflation_t$ is the forecast inflation for Regulatory Year t (t = 2012 to 2015), expressed in decimal (as opposed to percentage) terms, which is used by the ERC for the purpose of the Regulatory Reset Process for the Third Regulatory Period under Article VII. The inflation calculation is based on the Philippines CPI index and annual inflation is determined in accordance with the DeltaCPI calculation described in section 4.5.2.

4.15.4 The Smoothed Maximum Annual Price cap (SMAP) for each Regulatory Year in the Third Regulatory Period is calculated as follows :

- (a) where the relevant Regulatory Year is the first Regulatory Year in the Third Regulatory Period, the Smoothed Maximum Annual Price cap for that Regulatory Year ($SMAP_{2012}$) is:

$$SMAP_{2012} = (MAP_{2011} - P_0) \times (1 + Inflation_{2012} - X); \text{ and}$$

- (b) where the relevant Regulatory Year is any Regulatory Year in the Third Regulatory Period after the first Regulatory Year, the Smoothed Maximum Annual Price cap for that Regulatory Year ($SMAP_t$) is:

$$SMAP_t = SMAP_{t-1} \times (1 + Inflation_t - X) ,$$

Where:

MAP_{2011} = The MAP determined by the ERC for the last year of the Second Regulatory Period;

Inflation_t = the forecast inflation for Regulatory Year t, expressed in decimal (as opposed to percentage) terms, which is used by the ERC for the purpose of the Regulatory Reset Process for the Third Regulatory Period under Article VII;

P₀ is the amount determined by the ERC as described in Section 4.15.3;

and

X is as calculated pursuant to Section 4.15.3.

4.15.5 Where the ERC in terms of Section 4.15.1 decides that earlier under- or over-recoveries are to be recovered as part of the smoothed price path during the Third Regulatory Period (rather than be fully recovered in terms of Section 4.3), the outstanding recovery amount will be split and added (if it is an under-recovery) or subtracted (if it is an over-recovery) from the annual revenue requirement for two or more Regulatory Years during the Third Regulatory Period. The annual revenue requirements thus adapted will be applied for the calculation of PVR₂₀₁₁ described in section 4.15.2. For the purposes of this calculation, with the exception of the allowance made in Section 4.15.2 and 4.15.3, no interest or any other compensation to reflect the time-value of money under- or over-recovered will be applied.

4.15.6 Earlier regulatory interventions by the ERC, that affected the price control arrangements for the Second Regulatory Period for any Regulated Entity, will be recovered during the Third Regulatory Period. The total regulatory intervention amount will be evenly split and added to the annual revenue requirement for each Regulatory Years during the Third Regulatory Period. The annual revenue requirements thus adapted will be applied for the calculation of PVR₂₀₁₁ described in section 4.15.2. For the purposes of this calculation, with the exception of the allowance made in Section 4.15.2 and 4.15.3, no interest or any other compensation to reflect the time-value of money involved in a regulatory intervention will be applied.

4.16 Revenue Path Transition

4.16.1 No revenue path transition will apply to Entrant Groups at the Third or later Entry Points.

4.17 Force Majeure and Tax Event Pass Throughs

4.17.1 Cost recovery arising from an approved Force Majeure Pass Through Amount, an Approved Tax Pass Through Amount or a Negative Tax Pass Through Amount as determined under Article X or XI (as the case may be), that has not been resolved at the end of the Second Regulatory Period will not form part of the Building Block analysis for the Third Regulatory Period, even if these have not been resolved at the end of the Second Regulatory Period. Similarly, cost recoveries that has not been resolved at the end of the Third Regulatory Period, will not be carried forward to the Fourth Regulatory Period.

4.18 Service Quality Measures and Targets

4.18.1 The ERC must implement a performance incentive scheme that rewards each Regulated Entity for achieving specified target levels of performance, and penalizes each Regulated Entity for failing to achieve specified target levels of performance,

during the Third Regulatory Period in accordance with Article VIII, as described in Sections 8.2.5 and 8.2.6.

- 4.18.2 The performance incentive scheme for the Third Regulatory Period will include a price-linked incentive component which will be used to determine the S_t factor described in 4.2.1 for each Regulatory Year t .
- 4.18.3 The performance incentive scheme for the Third Regulatory Period will include a guaranteed service level scheme in terms of which Regulated Entities will compensate a Customer directly if certain service delivery performance thresholds are not met.
- 4.18.4 The performance targets used for the Third Regulatory Period may be based on historical service performance levels achieved by a Regulated Entity, or may reflect a measure of improvement as determined by the ERC, based on benchmarking performance levels against other Philippines and international electricity distribution utilities. Such benchmarking and subsequent performance improvements will be subjected to public consultation before being adopted into a performance incentive scheme for the Third Regulatory Period.

4.19 Efficiency Adjustments

- 4.19.1 The ERC must comply with Article IX in respect of the treatment of Net Efficiency Adjustments (as defined in Article IX) which arise during the Third Regulatory Period.
- 4.19.2 Efficiency Adjustments will also be made to reflect efficiency gains achieved by Regulated Entities during the Second Regulatory Period.

4.20 Change in Weighted Index

- 4.20.1 During the Regulatory Reset Process for the Third Regulatory Period under Article VII, the ERC must review the values of W_1 and W_2 as set out in Section 3.3 to determine whether they appropriately reflect those proportions of the capital expenditure forecasts, and the operating and maintenance expenditure forecasts, for that Regulatory Period which are approved by the ERC in relation to a Regulated Distribution System under Sections 4.12.5 and 4.13.5 and which are to be undertaken in or are otherwise referable to a foreign currency.
- 4.20.2 If, as a result of its review under Section 4.20.1, the ERC determines that the values of any of W_1 or W_2 as set out in Section 3.3 should be altered to more appropriately reflect those proportions of the capital expenditure forecasts, and the operating and maintenance expenditure forecasts, referred to in Section 4.20.1, then the ERC must determine the altered values and those altered values must be used in applying the formula for the calculation of MAP_t for the relevant Regulated Distribution System as set out in Section 4.2.1. Without limiting the way in which the ERC may determine to alter the values of W_1 or W_2 for the purposes of this Section 4.20.2, the ERC may determine values which are constant for the whole of the Third Regulatory Period or that are different for each Regulatory Year in the Third Regulatory Period. The values of W_1 and W_2 as determined pursuant to this Section 4.20.2 must not be changed during the Third Regulatory Period.

4.20.3 For the avoidance of doubt, the values of W1 and W2 that are used in applying the formula for the calculation of MAP_t for a Regulated Distribution System as set out in Section 4.2.1 may vary as between Regulated Distribution Systems.

4.21 Side Constraint

During the Regulatory Reset Process for the Third Regulatory Period under Article VII, the ERC must determine, in respect of each Regulated Distribution System, the amount of the Side Constraint referred to in Section 6.4.1, which amount must be the same for each Regulatory Year in the Third Regulatory Period (but may vary as between Regulated Distribution Systems).

4.22 Quantity Forecasts

4.22.1 During the Regulatory Reset Process for the Third Regulatory Period under Article VII, each Regulated Entity must provide the ERC with its forecasts, for each Regulatory Year in the Third Regulatory Period, of the total amount of energy (expressed in kWh) forecasted to be delivered through each Regulated Distribution System operated by it, during that Regulatory Year, to Distribution Connection Points in respect of that Regulated Distribution System, such amount of energy being forecasted in a manner that is approved for this purpose by the ERC.

4.22.2 During the Regulatory Reset Process for the Third Regulatory Period under Article VII, each Regulated Entity must provide the ERC with its forecasts, for each Regulatory Year in the Third Regulatory Period, of the total maximum demand¹⁷ (expressed in MW¹⁸) forecasted of each Regulated Distribution System operated by it, during that Regulatory Year. These demand forecasts should be broken down into the following level of detail for each Regulatory Year:

- (a) co-incident maximum demand for the Regulated Distribution System, as measured at all Grid Connection Points and connection points to generators, including embedded generation;
- (b) maximum demand at each Grid Connection Point and connection points to generators, including embedded generation;
- (c) maximum demand at each major substation forming part of a Regulated Distribution System;
- (d) maximum demand on each sub-transmission feeder (or combination of feeders where redundancy is built into the system); and
- (e) maximum demand on each major distribution feeder (or combination of feeders where redundancy is built into the system).

4.22.3 During the Regulatory Reset Process for the Third Regulatory Period under Article VII, each Regulated Entity must also provide the ERC with its historical energy

¹⁷ The maximum demand at any point is defined as the highest peak demand experienced there (or forecast to be experienced) over any half-hour period (or other period as approved) during a Regulatory Year. Half-hourly demand will be determined by integrating (numerically or otherwise) the instantaneous demand experienced at that point for the half-hourly period.

¹⁸ Where demand is measured in apparent power terms (MVA), an appropriate conversion should be made to real power (MW) using historical evidence of the power factor experienced during peak demand times.

consumption and maximum demand figures, in relation to each Regulated Distribution System that is operated by it, for each of the four Regulatory Years up to June 30, 2010, as well as the budgeted consumption and maximum demand for Regulatory Year 2011 (the budget period must include the Regulated Entity's best estimates).

- 4.22.4 The ERC must review the forecasts and historical figures referred to in Sections 4.23.1, 4.23.2 and 4.23.3 to determine whether they are reasonable. For this the ERC may engage a Regulatory Reset Expert or Regulatory Reset Experts pursuant to Article XIV, or may conduct the review internally. If the review is conducted by a Regulatory Reset Expert or Regulatory Reset Experts, once they present their written reports to the ERC, the ERC must decide, following a consideration of the recommendations of the Regulatory Reset Expert or Regulatory Reset Experts as provided in their written reports, whether the relevant forecasts are reasonable. If:
- (a) the ERC decides that those forecasts are reasonable, it must approve them;
 - (b) the ERC decides that those forecasts are not reasonable, it must, after consulting with the relevant Regulated Entity, approve those forecasts with such amendments as the ERC considers necessary to make them reasonable.

ARTICLE V
SUBSEQUENT REGULATORY PERIODS

5.1 General Principles

- 5.1.1 A revised version of the RDWR will be issued at the start of the Regulatory Reset Period, for each Entry Group. This will contain any changes to the rules as deemed necessary by the ERC for the next Regulatory Period. (This current version is an update of the RDWR issued for the First Entry Group for the Second Regulatory Period.)
- 5.1.2 Each revision of the RDWR will initially be issued in draft format and will be subjected to public consultation. Following this consultation, a final version of the RDWR will be issued. If further rule changes during a Regulatory Period are contemplated by the ERC, any such changes will only be effected after full further public consultation and after consideration of all valid submissions received on such rule changes.

ARTICLE VI

ANNUAL VERIFICATION AND ADJUSTMENT OF DISTRIBUTION TARIFFS

6.1 Annual Distribution Rate Setting

- 6.1.1 This Article VI applies to the maximum average distribution wheeling rate that may be charged by a Regulated Entity for the provision of Regulated Distribution Services in respect of a Regulated Distribution System during a Regulatory Year, as well as to the translation of this maximum average distribution wheeling rate into a distribution rate structure, describing the distribution tariffs for each Customer Segment served by a Regulated Distribution System.
- 6.1.2 The maximum average distribution wheeling rate and the distribution tariffs that may be charged by a Regulated Entity for the provision of Regulated Distribution Services in respect of a Regulated Distribution System during a Regulatory Year may only be set and changed in accordance with this Article VI and the DSOAR¹⁹, following an annual rate application and review that is conducted in accordance with this Article VI and the DSOAR.

6.2 Annual Rate Setting Timetable

- 6.2.1 Subject to the requirements of any applicable law, the annual review of the maximum average distribution wheeling rate and the distribution tariffs that may be charged by a Regulated Entity for the provision of Regulated Distribution Services in respect of a Regulated Distribution System during a Regulatory Year (such Regulatory Year being referred to for the purposes of this Article VI as the Application Year) must proceed according to the following timetable and process:
- (a) During the month of February prior to the commencement of the Application Year, the Regulated Entity must gather the data and information referred to in Section 6.3.2 in respect of the 12 month period ending on the immediately preceding December 31 (such period being referred to as the Historical Period), this being:
- the amount billed to Customers of that Regulated Distribution System for the provision by the Regulated Entity of Regulated Distribution Services in respect of that Regulated Distribution System during the Historical Period (as determined, adjusted and audited in accordance with Sections 4.3.1 or 4.5, as applicable) (see Sections 4.3, 4.5 and 5.1);
 - the net income derived, during the Historical Period, from each related business undertaking which is engaged in directly or indirectly by the Regulated Entity and which utilizes assets that form part of the regulatory asset base for that Regulated Distribution System (see Sections 4.3, 4.5 and 5.1);
 - the total amount of energy (expressed in kWh) delivered through that Regulated Distribution System, during the Historical Period, to Distribution Connection Points in respect of that Regulated Distribution

¹⁹ Distribution Services and Open Access Rules

Rules for Setting Distribution Wheeling Rates
First Entry Group : 3rd Regulatory Period

- System (as determined and audited in accordance with Sections 4.3.1 or 4.5, as applicable) (see Sections 4.3, 4.5 and 5.1);
- the simple average of the monthly 180 day weighted-average Manila Reference Rate in nominal percent per annum terms published by the Bangko Sentral ng Pilipinas for the Historical Period (see Sections 4.3 and 5.1);
 - the Correction Factor under the over/under recovery formula for the Application Year (K_t) (see Sections 4.3 and 5.1);
 - the performance incentive factor for the Application Year (S_t) (see Sections 4.2.1 and 4.18.2);
 - the change in Weighted Index for the Application Year (CWI_t) (see Sections 4.2, 4.5, 5.1 and 5.2);
 - to the extent it applies, the Tax Adjustment for the Application Year (ITA_t) (see Sections 4.4 and 5.1);
 - the maximum average price (expressed in PhP/kWh) that the Regulated Entity is permitted to charge for the provision by it, during the Application Year, of Regulated Distribution Services in respect of that Regulated Distribution System (MAP_t) (see Sections 4.2, 5.1 and 5.2); and
 - such other items as the ERC may specify from time to time for the purposes of these Rules (for this purpose the ERC may also specify that the Regulated Entity need not calculate one or more of the items referred to above).
- (b) On or before the March 31 which immediately precedes the commencement of the Application Year, the Regulated Entity must file an application for the maximum average distribution wheeling rate for the Application Year (MAP_t as described in Section 4.2.1) and for an adjustment of its distribution tariffs for each Customer Segment for the Application Year resulting from the translation of this maximum average distribution wheeling rate into tariffs. This application must be filed in accordance with the Rules of Practice and Procedure.
- (c) As part of this rate application Regulated Entities must submit to the ERC, in both written and soft copy form, all information used in its calculation of the maximum average distribution wheeling rate, together with a statement that demonstrates the compliance (or likely compliance) of this proposed maximum average distribution wheeling rate with the requirements of these Rules (including, in particular, Sections 4.1.2, 6.4 and 6.5 (as applicable)) and the DSOAR.
- (d) The Regulated Entity must also submit its proposal for translating the maximum average distribution wheeling rate into distribution tariffs for each Customer Segment for the provision of Regulated Distribution Services in respect of the relevant Regulated Distribution System during the Application Year. This proposal must clearly describe the basis on which the distribution tariffs were determined for each Customer Segment, the allocation of costs to each Customer Segment, functionalization factors used and the calculations and supporting

material for the proposal. A statement must be provided to confirm the absence of interclass cross-subsidies between Customer Segments (with the exception of customers on a lifeline rate, who may be cross-subsidized) and a demonstration that the side constraints discussed in Section 6.4 will not be breached for any Customer Segment.

- (e) The rate application by the Regulated Entity must clearly indicate the data used in calculating the proposed maximum distribution wheeling rate and the distribution tariffs, and the source of all data used, and must provide an explanation of each calculation and its outcome, so that there is no ambiguity for the ERC in interpreting how the Regulated Entity has calculated the proposed maximum distribution wheeling rates and distribution tariffs.
- (f) In accordance with the Rules of Practice and Procedure, the rate applications must be publicly advertised to allow interested parties the opportunities to register as parties of record to the rate case and to appear and contribute to the public hearings that will be held on the rate applications.
- (g) Public hearings on the rate applications will be held during the first two weeks of May which immediately precedes the commencement of the Application Year, at venues to be decided by the ERC. At these meetings the ERC will put questions to the Regulated Entities about their rate applications and parties of record to the case will be allowed to cross-examine the witnesses put forward by Regulated Entities to defend their rate applications.²⁰
- (h) Where the ERC requires such by notice in writing or by instruction issued during the public hearings, the Regulated Entity must file with the ERC, in accordance with the Rules of Practice and Procedure, further information on the proposed maximum distribution wheeling rate or distribution tariffs set out in its submission, and such further information must be so provided before the May 20 which immediately precedes the commencement of the Application Year.
- (i) The ERC must, on or before the May 31 which immediately precedes the commencement of the Application Year, determine whether or not the maximum distribution wheeling rate and distribution tariffs proposed by the Regulated Entity in its submission (as such submission may be amended with the approval of the ERC) comply (or are likely to comply) with the requirements of these Rules (including, in particular, Sections 4.1.2, 5.1.3, 6.4 and 6.5 (as applicable)) and the DSOAR. If:
 - 1) the ERC is satisfied that such rate and tariffs do comply (or are likely to comply) with the requirements of these Rules and the DSOAR, an order will be issued in this regard to the Regulated Entity and the Regulated Entity must, after advertising this intention four weeks in advance in a local newspaper of general circulation, implement those tariffs with effect from July 1 of the Application Year;

²⁰ It should be noted that the questions and cross-examinations will be limited to aspects pertaining to the rate application only. Information accepted as part of earlier processes by the ERC, or earlier regulatory decisions will not be open for questions or cross-examination – including decisions made during the Regulatory Reset Process leading up to the determination of the initial maximum average distribution wheeling rate for a Regulatory Period.

- 2) the ERC is not satisfied that such rate or tariffs comply (or are likely to comply) with the requirements of these Rules and the DSOAR:
 - (A) the Regulated Entity must amend its proposed maximum distribution wheeling rate and/or distribution tariffs in accordance with such directions as the ERC (after consulting with the Regulated Entity) may give for the purposes of ensuring that this rate and/or tariffs comply (or are likely to comply) with the requirements of these Rules and the DSOAR; and
 - (B) on receiving an order from the ERC approving the amended rate and/or tariffs, the Regulated Entity must implement those amended tariffs, after advertising this intention four weeks in advance in a local newspaper of general circulation, but not earlier than July 1 of the Application Year (pending which the Regulated Entity must continue to apply its existing rate and tariffs).
 - (j) If the Regulated Entity fails to file its submission on its proposed maximum distribution wheeling rate and distribution tariffs before the March 31 which immediately precedes the commencement of the Application Year (as required under Section 6.2.1 (b)), the maximum distribution wheeling rate that may be charged by it for the provision of Regulated Distribution Services in respect of the relevant Regulated Distribution System during the Application Year will be such rates as are determined by the ERC (being rates that the ERC is satisfied comply (or are likely to comply) with the requirements of these Rules and the DSOAR), pending which the Regulated Entity must continue to apply its existing rate and distribution tariffs.
 - (k) A failure by the Regulated Entity to file a submission or any further information as required under Section 6.2.1 (b) or (e) is a breach of these Rules and the ERC may impose a fine or penalty under Section 43 (l) of the EPIRA for such a breach.
- 6.2.2 The DSOAR set out the manner in which Regulated Entities must pass through to Customers of the Regulated Distribution Systems that are operated by them:
- (a) the transmission wheeling rate charges that are imposed on those Regulated Entities; and
 - (b) such other amounts as are specified in the Transmission Wheeling Rate Guidelines to be in addition to, or in reduction of, the maximum amounts that the "Regulated Entity" is otherwise permitted to charge "Customers" for "Regulated Transmission Services" (as those terms are defined in those guidelines) and as are payable by or for the benefit of those Regulated Entities in their capacity as such "Customers".
- 6.2.3 The amounts so passed through are not to be taken into account in the calculation of the maximum average prices that such Regulated Entities are permitted to charge for the provision by them of Regulated Distribution Services in respect of the Regulated Distribution Systems that are operated by them, or in determining whether those prices have been exceeded.

6.3 Annual Actual and Forecast Data Requirements

6.3.1 The data required for the purposes of the calculations referred to in Section 6.2.1 includes financial and operational data on actual outcomes and forecasts of that data.

6.3.2 The historical financial and operational data that must be provided to the ERC will depend on the components of the price control formula which is determined by the ERC to apply for the Application Year. However, until the ERC determines otherwise, each Regulated Entity must provide the ERC, as part of its rate application as described in Section 6.2.1(a), with at least the following historical financial and operational data (such data being provided in both written and soft copy form):

(a) the total amount (expressed in PhP) billed to all Customers of the relevant Regulated Distribution System in each Customer Segment for the provision by the Regulated Entity, during the Historical Period, of Regulated Distribution Services in respect of that Regulated Distribution System, the amount:

- so billed being determined in a manner that is approved for this purpose by the ERC; and
- as so determined being audited to the satisfaction of the ERC by a person that is approved for this purpose by the ERC ($CR_{k,t-1}$) (see Section 6.4);

(b) the maximum distribution wheeling rates it has applied to each Customer Segment in respect of the relevant Regulated Distribution System during the Historical Period; and

(c) the actual distribution wheeling rates it has applied to each Customer Segment in respect of the relevant Regulated Distribution System during the Historical Period; and

(d) the total amount of energy (expressed in kWh) delivered through the relevant Regulated Distribution System, during the Historical Period, to all Customers of that Regulated Distribution System in each Customer Segment, the amount of energy so delivered:

- being determined in a manner that is approved for this purpose by the ERC; and
- as so determined being audited to the satisfaction of the ERC by a person that is approved for this purpose by the ERC ($AQ_{k,t-1}$) (see Section 6.4).

6.3.3 The forecast financial and operational data that must be provided to the ERC will depend on the components of the price control formula which is determined by the ERC to apply for the Application Year. However, until the ERC determines otherwise, each Regulated Entity must provide the ERC, as part of its rate application as described in Section 6.2.1(a), with at least the following forecast financial and operational data (such data being provided in both written and soft copy form):

(a) the total amount (expressed in PhP) forecasted to be billed to all Customers of the relevant Regulated Distribution System in each Customer Segment for the provision by the Regulated Entity, during the 12 month period ending on December 31 in the Application Year (the Forecast Period), of Regulated Distribution Services in respect of that Regulated Distribution System, the

amount so forecasted being determined in a manner that is approved for this purpose by the ERC ($FCR_{k,t}$) (see Section 6.4); and

- (b) the total amount of energy (expressed in kWh) forecasted to be delivered through the relevant Regulated Distribution System, during the Forecast Period, to all Customers of that Regulated Distribution System in each Customer Segment, the amount so forecasted being determined in a manner that is approved for this purpose by the ERC ($FQ_{k,t}$) (see Section 6.4).

6.4 Side Constraints on Proposed Maximum Distribution Wheeling Rates

- 6.4.1 Subject to Section 6.5, the maximum distribution wheeling rates that may be charged by a Regulated Entity for the provision of Regulated Distribution Services in respect of a Regulated Distribution System during an Application Year to a Customer Segment in respect of that Regulated Distribution System (k) must comply with the following condition:

$$\frac{((FCR_{k,t} / FQ_{k,t}) - S_t) - ((CR_{k,t-1} / AQ_{k,t-1}) - S_{t-1})}{((CR_{k,t-1} / AQ_{k,t-1}) - S_{t-1})} \leq (CWI_t + SC_t)$$

Where:

- $FCR_{k,t}$ = the total amount (expressed in PhP) forecasted to be billed to all Customers of the Regulated Distribution System in Customer Segment k for the provision by the Regulated Entity, during the Forecast Period, of Regulated Distribution Services in respect of the Regulated Distribution System, as provided under Section 6.3.3(a);
- $CR_{k,t-1}$ = the total amount (expressed in PhP) billed to all Customers of the Regulated Distribution System in Customer Segment k for the provision by the Regulated Entity, during the Historical Period, of Regulated Distribution Services in respect of the Regulated Distribution System, as provided under Section 6.3.2(a);
- “ \leq ” = less than or equal to;
- SC_t = the Side Constraint in respect of the Regulated Distribution System for Regulatory Year t, which is such amount as the ERC determines for that Regulatory Period, during the Regulatory Reset Process for the Third Regulatory Period under Article VII, having regard to the needs of End-users (for the avoidance of doubt, such amount may vary as between Regulated Distribution Systems);
- CWI_t = the change in Weighted Index for Regulatory Year t as calculated in accordance with Section 4.5.1;
- $FQ_{k,t}$ = the total amount of energy (expressed in kWh) forecasted to be delivered through the Regulated Distribution System, during the Forecast Period, to all Customers of that Regulated Distribution System in Customer Segment k, as provided under Section 6.3.3(b); and

- $AQ_{k, t-1}$ = the total amount of energy (expressed in kWh) delivered through the Regulated Distribution System, during the Historical Period, to all Customers of that Regulated Distribution System in Customer Segment k, as provided under Section 6.3.2(d).
- S_t = the performance incentive factor calculated for the application year, Regulatory Year t (see Sections 4.2.1, 4.18.2 and 6.2.1)
- S_{t-1} = the performance incentive factor calculated for Regulatory Year t-1 (see Sections 4.2.1 and 4.18.2)

For the sake of clarity, it should be noted that the computation of the side constraints does not include any amounts that may be earned in terms of Article X (Force Majeure pass through events) or Article XI (Tax Event pass through). Revenue earned for such pass through events will be excluded from the calculation above.

- 6.4.2 In situations where a Regulated Entity has experienced major under-recovery of revenue during the Historical Period, the side-constraints could prevent the correction factor (K_t as described in Sections 4.2.1 and 4.3) from being fully incorporated in the adjusted rates for the Application Year. Similarly, following a re-opening event as described in Article XII, the side constraints could prevent the adjusted rates from being fully implemented. In such an event, the ERC may at its discretion, after consulting with a Regulated Entity and considering the impact of its decision on the Regulated Entity's consumers, relax the side constraints for one or more Customer Segments during the Application Year. The ERC may also decide to carry over all or part of such under-recoveries into the next Regulatory Period, where it will be considered in the calculation of the Smoothed Price Path for the next Regulatory Period, in accordance with Sections 4.15.1 and 4.15.5.

6.5 Other parameters

- 6.5.1 The maximum distribution wheeling rates that may be charged by a Regulated Entity for the provision of Regulated Distribution Services in respect of a Regulated Distribution System must:
- (a) comply with the requirements of any applicable law (including the EPIRA and the IRR);
 - (b) comply with applicable requirements that apply to such rates as set out in any applicable ERC order;
 - (c) be such as to result in the removal of cross subsidies in accordance with the applicable requirements of any law or of any order by the ERC; and
 - (d) comply with the applicable requirements of any law or order made by the ERC relating to the treatment of system losses.

ARTICLE VII
REGULATORY RESET PROCESS

7.1 Regulatory Reset Process Timelines

7.1.1 Prior to the commencement of each Regulatory Period the ERC will undertake a Regulatory Reset Process pursuant to this Article VII. This process will, in accordance with this Article VII, entail consultation in respect of the ERC's proposals for the price control arrangements that are to apply for that Regulatory Period.

7.1.2 The ERC must publish a Regulatory Reset Issues Paper not less than 21 months prior to the end of each Regulatory Period. The Regulatory Reset Issues Paper must:

- (a) provide the ERC's initial views on the issues raised by the pending Regulatory Reset Process;
- (b) specify the information to be provided by each Regulated Entity for the purposes of the Regulatory Reset Process and the time by which that information must be provided; and
- (c) the time by which each Regulated Entity must file an application with the ERC to commence the Regulatory Reset Process pursuant to this Article VII.

Each Regulated Entity must provide the information specified pursuant to paragraph (b) within the time specified under that paragraph.

7.1.3 The ERC must call for written submissions on the issues raised in the Regulatory Reset Issues Paper and must require that such submissions be delivered not later than two months after the publication of the Regulatory Reset Issues Paper. When all such written submissions have been received, the ERC must, within two weeks of the closing date for written submissions and subject to Section 7.1.4, publish all such submissions on its web site (subject to normal internet service provider performance), or through such other electronic medium as is generally accepted and in use at that time, and have hard copies of them available for purchase from its offices.

7.1.4 Where a written submission identifies information in it which is confidential, the ERC may only publish or otherwise disclose that information if the ERC has given written notification to the person who has made that submission of the ERC's intention to publish or otherwise disclose that information and either:

- (a) that person has not made a written submission to the ERC objecting to the publication or disclosure of that information (including reasons as to why publication or disclosure of the information would cause substantial commercial damage or harm to it) within two weeks of receiving the written notification; or
- (b) that person has made a written submission to the ERC objecting to the publication or disclosure of that information (including reasons as to why publication or disclosure of the information would cause substantial commercial damage or harm to it) but the ERC, after considering that submission, nevertheless decides that publication or disclosure of the information will not cause substantial commercial damage or harm to that person (in which case the

ERC must not publish or otherwise disclose that information unless it has first given the person not less than one week's notice of its decision).

- 7.1.5 Following the publication of the Regulatory Reset Issues Paper, the ERC could retain a Regulatory Reset Expert or Regulatory Reset Experts pursuant to Article XIV for the purpose of undertaking and preparing a written report in respect of each of the following:
- (a) the asset re-valuation in relation to each Regulated Distribution System that is operated by a Regulated Entity, as referred to in Section 4.8 or Section 5.5 (as applicable);
 - (b) for the purposes of the Regulatory Reset Process for the Third Regulatory Period, the condition of certain assets that are used to provide Regulated Distribution Services and the regulatory life which should be attributed to such assets (see Section 4.10.3);
 - (c) the determination of the weighted average cost of capital as referred to in Section 4.11;
 - (d) the review of each Regulated Entity's proposed capital expenditure in relation to each Regulated Distribution System that is operated by it, as referred to in Section 4.12;
 - (e) the review of each Regulated Entity's proposed operating and maintenance expenditure in relation to each Regulated Distribution System that is operated by it, as referred to in Section 4.13; and
 - (f) the review of each Regulated Entity's energy delivery forecasts as referred to in Section 4.23.

Alternatively the ERC could conduct one or more of these reviews internally, or in conjunction with Regulatory Reset Experts.

- 7.1.6 The reviews must commence at least 18 months prior to the start of the next relevant Regulatory Period, and be substantially concluded seven months prior to the start of that Regulatory Period.
- 7.1.7 Not later than six months prior to the commencement of the relevant Regulatory Period the ERC must publish a draft determination on the price control arrangements that are to apply for the relevant Regulatory Period on the ERC's website (subject to normal internet service provider performance) or through such other electronic medium as is generally accepted and in use at that time. Copies of the draft determination must also be available for purchase at the offices of the ERC.
- 7.1.8 The ERC must invite submissions on the draft determination, such submissions to be provided in writing or at public hearings convened for that purpose.
- 7.1.9 All written submissions must be made within 30 days of the publication of the draft determination and only those persons who make written submissions may participate in the relevant public hearings. Participation will be in accordance with the Rules of Practice and Procedure.
- 7.1.10 The relevant public hearings must be held during the period of five to four months prior to the commencement of the relevant Regulatory Period.

7.1.11 After considering all the submissions made to it in accordance with Sections 7.1.9 and 7.1.10, the ERC must publish a final determination on the price control arrangements that are to apply for the relevant Regulatory Period. Such final determination must be published not later than three-and-a-half months prior to the commencement of the relevant Regulatory Period on the ERC's website (subject to normal internet service provider performance) or through such other electronic medium as is generally accepted and in use at that time. Copies of the final determination must also be available for purchase at the offices of the ERC.

7.2 Rate Application prior to start of the Regulatory Period

7.2.1 After the ERC had made its final determination on the price control arrangements that are to apply for the relevant Regulatory Period, the Regulated Entity has to convert the decision on the initial maximum average price into distribution tariffs that will reflect the tariff applicable to each Customer Segment for providing Regulated Distribution Services during the first Regulatory Year.

7.2.2 The Regulated Entity has to file a rate application with the ERC by not later than three months prior to the start of the relevant Regulatory Period in which it indicates how it proposes to convert the initial maximum average price (MAP₂₀₁₂ as determined in accordance with Section 4.2.1(a)) determined by the ERC into distribution tariffs for each Customer Segment in its Regulated Distribution System. This application has to be filed in accordance with the Rules of Practice and Procedure and will constitute a formal rate case which will be subject to public hearings. The rate application has to be published in a local newspaper of substantial general circulation.

7.2.3 As part of the rate application, the Regulated Entity has to provide full details of how the maximum average distribution wheeling rate will be translated into distribution tariffs for each Customer Segment for the provision of Regulated Distribution Services in respect of the relevant Regulated Distribution System during the first Regulatory Year. This proposal must clearly describe the basis on which the distribution tariffs were determined for each Customer Segment, the allocation of costs to each Customer Segment, the functionalization factors used and the calculations and supporting material for the proposal. A statement must be provided to confirm the absence of interclass cross-subsidies between Customer Segments (with the exception of customers on a lifeline rate, who may be subsidized). The rate application must also clearly indicate the data used in calculating the proposed distribution tariffs, the source of all data used, and must provide an explanation of each calculation and its outcome, so that there is no ambiguity for the ERC in interpreting how the Regulated Entity calculated the proposed distribution tariffs.

7.2.4 Public hearings on the rate application will be held during the first two weeks of February, prior to the start of the relevant Regulatory Period. At these hearings the ERC will have the opportunity to question the Regulated Entity on its proposed distribution tariffs and parties of record to the rate case will have opportunity to cross-examine witnesses put forward by the Regulated Entity to defend its application.²¹

²¹ Note that questions and cross-examination will only be allowed on aspects relevant to the rate application and not on earlier regulatory decisions or the basis on which these were made. For example, cross-examination

- 7.2.5 Where the ERC requires such by notice in writing or by instruction issued during the public hearings, the Regulated Entity must file with the ERC, in accordance with the Rules of Practice and Procedure, further information on the proposed distribution tariffs set out in its submission, and such further information must be so provided before the February 20 which immediately precedes the commencement of the first Regulatory Year.
- 7.2.6 The ERC must, on or before the February 28 which immediately precedes the commencement of the first Regulatory Year, determine whether or not the distribution tariffs proposed by the Regulated Entity in its submission (as such submission may be amended with the approval of the ERC) is consistent with the final determination on the price control arrangements for the relevant Regulatory Period and comply (or are likely to comply) with the requirements of the DSOAR. If:
- the ERC is satisfied that such tariffs are consistent and do comply (or are likely to comply) with the requirements of these Rules and the DSOAR, an order will be issued in this regard to the Regulated Entity and the Regulated Entity must, after advertising this intention four weeks in advance in a local newspaper of general circulation, implement those tariffs with effect from July 1 of the first Regulatory Year;
 - the ERC is not satisfied that tariffs are consistent and comply (or are likely to comply) with the requirements of these Rules and the DSOAR:
 - (A) the Regulated Entity must amend its proposed distribution tariffs in accordance with such directions as the ERC (after consulting with the Regulated Entity) may give for the purposes of ensuring that these tariffs are consistent and comply (or are likely to comply) with the requirements of these Rules and the DSOAR; and
 - (B) on receiving an order from the ERC approving the amended tariffs, the Regulated Entity must implement those amended tariffs, after advertising this intention four weeks in advance in a local newspaper of general circulation, but not earlier than July 1 of the first Regulatory Year.

on aspects decided by the ERC in its final determination on the price control arrangements for the relevant Regulatory Period will not be accepted at these hearings.

ARTICLE VIII

SERVICE QUALITY MEASURES AND TARGETS

8.1 Establishment of Distribution Performance Standards

8.1.1 As part of its final determination of the price control arrangements for the Third Regulatory Period, the ERC must, subject to Section 8.1.3, determine:

- (a) the indices that are to be used for the purposes of these Rules to measure:
 - the performance of each Regulated Distribution System; and
 - the service performance of the Regulated Entity that operates that Regulated Distribution System;and which for the Third and subsequent Regulatory Periods will be in accordance with those indices specified as part of the performance incentive scheme described in Appendix B;
- (b) for each of the indices referred to in paragraph (a), the target level of performance of the relevant Regulated Distribution System or the target level of service performance of the relevant Regulated Entity (as the case may be) for each Regulatory Year occurring during the Third Regulatory Period, as measured by that index;
- (c) the manner in which each Regulated Entity must record the actual performance of each Regulated Distribution System that is operated by it, and the actual service performance of that Regulated Entity, as measured by each of the indices referred to in paragraph (a);
- (d) the manner and form in which, and the time by which, each Regulated Entity must report to the ERC on the actual performance of each Regulated Distribution System that is operated by it, and the actual service performance of that Regulated Entity, for each Regulatory Year occurring during the Third Regulatory Period, as measured by each of the indices referred to in paragraph (a); and
- (e) the circumstances in which the ERC may grant permission for a period of performance to be excluded for the purposes of measuring the performance of a Regulated Distribution System, or the service performance of a Regulated Entity in restoring Regulated Distribution Services in respect of a Regulated Distribution System following the outage of a component of that Regulated Distribution System, using the indices referred to in paragraph (a) (as a minimum such circumstances must include the events provided in clause 3.3.3.2(b), (d) and (e) of the Distribution Code).

For the purposes of assisting the ERC to determine the matters referred to in this Section 8.1.1, each Regulated Entity must as soon as practicable after the Effectivity Date provide the ERC with such information as the ERC requires under clause 3.3 of Distribution Code.

8.1.2 The target levels of performance determined under Section 8.1.1(b) may vary as between Regulatory Years, as between different Regulated Entities and different

Regulated Distribution Systems, and as between the location of different parts of the same Regulated Distribution System.

- 8.1.3 The ERC must determine the matters referred to in Section 8.1.1 after consultation with such persons as it thinks appropriate and after taking into account:
- (a) accepted international practices, or accepted Philippines electricity industry practices, in relation to the matters referred to in Section 8.1.1;
 - (b) the measures which a Regulated Entity can reasonably be required to implement for the purposes of meeting the target levels of performance referred to in Section 8.1.1(b) and complying with the obligations regarding recording and reporting referred to in Sections 8.1.1(c) and (d);
 - (c) the capital expenditure program for a Regulated Distribution System that is approved by the ERC under Section 4.12;
 - (d) the relevant provisions of the Distribution Code and any relevant guidelines promulgated pursuant to the Distribution Code; and
 - (e) any other factors the ERC considers relevant.

8.2 Performance Incentive Scheme

- 8.2.1 As part of the Regulatory Reset Process for the Third Regulatory Period under Article VII, the ERC must develop a performance incentive scheme that:
- (a) rewards each Regulated Entity to the extent that the actual level of performance of a Regulated Distribution System that is operated by that Regulated Entity or the actual level of service performance of that Regulated Entity (as the case may be) for a Regulatory Year, as measured by the indices referred to in Section 8.1.1(a), exceeds the target level of performance of that Regulated Distribution System or the target level of service performance of that Regulated Entity (as the case may be) for that Regulatory Year, as determined under Section 8.1.1(b);
 - (b) penalizes each Regulated Entity to the extent that the actual level of performance of a Regulated Distribution System that is operated by that Regulated Entity or the actual level of service performance of that Regulated Entity (as the case may be) for a Regulatory Year, as measured by the indices referred to in Section 8.1.1(a), is below the target level of performance of that Regulated Distribution System or the target level of service performance of that Regulated Entity (as the case may be) for that Regulatory Year, as determined under Section 8.1.1(b); and
 - (c) complies with the principles set out in Section 8.2.3.
- 8.2.2 Without limiting the nature of the scheme referred to in Section 8.2.1, such scheme may take the form of:
- (a) a scheme under which each Regulated Entity:
 - is entitled to an increase in the maximum average price that Regulated Entity is permitted to charge for the provision by it, during a Regulatory Year, of Regulated Distribution Services in respect of the relevant Regulated Distribution System (where Section 8.2.1(a) applies); or
 - suffers a decrease in the maximum average price that Regulated Entity is permitted to charge for the provision by it, during a Regulatory Year, of

Regulated Distribution Services in respect of the relevant Regulated Distribution System (where Section 8.2.1(b) applies); or

- (b) a scheme under which each Regulated Entity:
- is entitled to levy a surcharge on some or all of the Customers of the relevant Regulated Distribution System (where Section 8.2.1(a) applies); or
 - is required to pay a rebate to some or all of the Customers of the relevant Regulated Distribution System (where Section 8.2.1(b) applies).

8.2.3 The levels of reward referred to in Section 8.2.1(a), and the levels of penalty referred to in Section 8.2.1(b), must conform with the following principles:

- (a) the levels of reward should be reasonable, and should be set so as to provide an incentive to improve the performance of each Regulated Distribution System, and of the Regulated Entity that operates that Regulated Distribution System, over time but not so as to encourage excessive investment in capacity, extension or interconnectivity of that Regulated Distribution System;
- (b) the levels of penalty should be reasonable, and should be set so as to be proportional to the levels of reward (with a larger penalty being payable the greater the differential between the actual and target levels of performance); and
- (c) the levels of reward and penalty must be set such that:
 - if the scheme is a scheme described in Section 8.2.2(a), the rewards and penalties applying in respect of any Regulatory Year do not exceed 3% of the allowed annual revenue requirement for the relevant Regulated Distribution System for that Regulatory Year, as determined for the purposes of the Regulatory Reset Process undertaken under Article VII in respect of the Third Regulatory Period;
 - if the scheme is a scheme described in Section 8.2.2(b), the rewards and penalties applying in respect of any Regulatory Year:
 - (A) do not exceed 10% of the average monthly distribution wheeling rate tariff applicable to affected connections of the relevant Customers; and
 - (B) do not exceed 3% of the allowed annual revenue requirement for the relevant Regulated Distribution System for that Regulatory Year, as determined for the purposes of the Regulatory Reset Process undertaken under Article VII in respect of the Third Regulatory Period; and
 - if the scheme is a combination of the above schemes, the scheme must be such that the rewards and penalties applying in respect of any Regulatory Year do not exceed the above limits.

8.2.4 In Appendix B, the performance incentive that will apply to all Regulated Entities for the Third Regulatory Period and subsequent Regulatory Periods is described.

ARTICLE IX

OPEX AND CAPEX EFFICIENCY ADJUSTMENTS

9.1 General Efficiency Adjustment Principles

9.1.1 The Net Efficiency Adjustment in respect of a Regulated Distribution System is designed to ensure that the Regulated Entity that operates that Regulated Distribution System has an incentive to achieve cost reductions in controllable costs above those contained in forecasts approved by the ERC as part of the Regulatory Reset Process for a Regulatory Period under Article VII.

9.1.2 If,

(a) during the Regulatory Reset Process for the Third Regulatory Period under Article VII, the ERC determines that the historical service delivery levels existing prior to the Second Regulatory Period in respect of a Regulated Distribution System have not been maintained on average during the Second Regulatory Period, or

(b) during the Regulatory Reset Process for the Fourth Regulatory Period under Article VII, the ERC determines that the historical service delivery levels existing prior to the Third Regulatory Period in respect of a Regulated Distribution System have not been maintained on average during the Third Regulatory Period,

the ERC may elect not to apply, or to adjust the Net Efficiency Adjustment in respect of that Regulated Distribution System.

9.2 Definition of Net Efficiency Adjustment

9.2.1 The Net Efficiency Adjustment in respect of a Regulated Distribution System for a Regulatory Year t in the Third Regulatory Period (EA_t) is calculated as follows:

$$EA_t = CEA_t + OEA_t$$

Where:

CEA_t is the Net Capital Efficiency Adjustment in respect of that Regulated Distribution System for Regulatory Year t, as defined in Section 9.2.2; and

OEA_t is the Net Operating and Maintenance Efficiency Adjustment in respect of that Regulated Distribution System for Regulatory Year t, as defined in Section 9.2.3.

9.2.2 The Net Capital Efficiency Adjustment in respect of a Regulated Distribution System for Regulatory Year t (CEA_t) is calculated as follows:

$$CEA_t = WACC \times (\text{Capex Forecast}_t - \text{Capex Actual}_t)$$

Where:

WACC = the classical weighted average cost of capital determined by the ERC in accordance with Section 4.11; and

Capex Forecast_t = the real capital expenditure forecasted for Regulatory Year t in relation to that Regulated Distribution System,

determined by deflating the nominal capital expenditure forecasted in relation to that Regulated Distribution System as approved by the ERC for Regulatory Year t pursuant to Section 4.12.5 (as such forecast is adjusted in accordance with Section 9.2.4) to accommodate actual changes in CPI over Regulatory Year t; and

Capex Actual_t = the actual real level of capital expenditure incurred in Regulatory Year t in respect of that Regulated Distribution System by the Regulated Entity that operates that Regulated Distribution System, determined by deflating that actual capital expenditure to accommodate actual changes in CPI over Regulatory Year t.

9.2.3 The Net Operating and Maintenance Efficiency Adjustment in respect of a Regulated Distribution System for Regulatory Year t (OEA_t), where t is not the first Regulatory Year of the Regulatory Period, is calculated as follows:

$$OEA_t = (\text{Opex Forecast}_t - \text{Opex Forecast}_{t-1}) - (\text{Opex Actual}_t - \text{Opex Actual}_{t-1})$$

Where t is the first Regulatory Year of a Regulatory Period, OEA_t is calculated as follows:

$$OEA_t = \text{Opex Forecast}_t - \text{Opex Actual}_t$$

and:

Opex Forecast_t = the nominal operating and maintenance expenditure forecasted in relation to that Regulated Distribution System that is approved by the ERC for Regulatory Year t pursuant to Section 4.13, as adjusted in accordance with Section 9.2.4;

Opex Forecast_{t-1} = the nominal operating and maintenance expenditure forecasted in relation to that Regulated Distribution System that is approved by the ERC for Regulatory Year t-1 pursuant to Section 4.13, as adjusted in accordance with Section 9.2.4;

Opex Actual_t = the actual nominal level of operating and maintenance expenditure incurred in Regulatory Year t in respect of that Regulated Distribution System by the Regulated Entity that operates that Regulated Distribution System; and

Opex Actual_{t-1} = the actual nominal level of operating and maintenance expenditure incurred in Regulatory Year t-1 in respect of that Regulated Distribution System by the Regulated Entity that operates that Regulated Distribution System.

9.2.4 For the purposes of calculating the Net Capital Efficiency Adjustment, or the Net Operating and Maintenance Efficiency Adjustment, in respect of a Regulated Distribution System for a Regulatory Year t the ERC may, at its discretion but after taking into account any submissions made by the Regulated Entity that operates that Regulated Distribution System, adjust the capital expenditure forecast in relation to that Regulated Distribution System that is approved by the ERC for Regulatory Year

t pursuant to Section 4.12.5 or the operating and maintenance expenditure forecast in relation to that Regulated Distribution System that is approved by the ERC for Regulatory Year t-1 or Regulatory Year t pursuant to Section 4.13.5 (as the case may be) so as to reflect:

- (a) changes in the scope of services provided and activities undertaken by that Regulated Entity from those which formed the basis of the forecasts (for example as a result of an acquisition of any Subtransmission Assets);
- (b) material differences between the forecast level of output of that Regulated Distribution System for a Regulatory Year (as accepted by the ERC) and the level of actual output of that Regulated Distribution System for that Regulatory Year, in each case as measured by the system co-incident maximum demand (for these purposes there will only be deemed to be such a material difference where the system co-incident maximum demand for the relevant Regulatory Year is greater than 105%, or is less than 95%, of the forecast system coincident maximum demand for that Regulatory Year (as accepted by the ERC));
- (c) material differences between the actual Philippine CPI as compared with the Philippine CPI figures used for the capital expenditure forecasts approved by the ERC pursuant to section 4.12.5 and operating and maintenance expenditure forecasts approved by the ERC pursuant to section 4.13.5 (for these purposes there will only be deemed to be such a material difference where the actual ΔCPI_t for a Regulatory Year as calculated in section 4.5.2, varies by more than 10% from the annual change in the CPI forecast by a Regulated Entity for Regulatory Year t, as calculated by using the ΔCPI_t formula in section 4.5.2 but substituting actual quarterly CPI figures with the Regulated Entity's approved quarterly forecast figures for the same period); and
- (d) material differences between the actual PhP/US\$ exchange rate and the USA CPI as compared with the exchange rate and USA CPI figures used for the capital expenditure forecasts approved by the ERC pursuant to section 4.12.5 and operating and maintenance expenditure forecasts approved by the ERC pursuant to section 4.13.5 (for these purposes there will only be deemed to be such a material difference where the actual ΔUSER_t for a Regulatory Year, as calculated in section 4.5.3, varies by more than 10% from the annual change in the exchange and CPI rates forecast by a Regulated Entity for Regulatory Year t, as calculated by using the ΔUSER_t formula in section 4.5.3 but substituting actual quarterly exchange rate and USA CPI figures with the Regulated Entity's approved quarterly exchange rate and USA CPI forecast figures for the same period).

Otherwise such forecasts will remain unchanged for the purposes of this Article IX. For the avoidance of doubt, the adjustment of any forecasts pursuant to this Section 9.2.4 is only for the purposes of this Article IX and does not apply for the purposes of any other Article.

- 9.2.5 At the time of the Regulatory Reset Process for the Third Regulatory Period under Article VII, the actual levels of capital expenditure and operating and maintenance expenditure incurred by a Regulated Entity in Regulatory Year 2011 in respect of a Regulated Distribution System that is operated by it will not be known. To address this:

- (a) each Regulated Entity must, during the Regulatory Reset Process, provide to the ERC its best estimate of its actual levels of capital expenditure, and of its actual levels of operating and maintenance expenditure, in respect of that Regulated Distribution System for Regulatory Year 2011; and
- (b) the ERC must determine the estimates of such amounts which are to be applied for the purpose of calculating the Net Efficiency Adjustment in respect of that Regulated Distribution System for Regulatory Year 2011.
- (c) The difference between the estimate applied by the ERC for this purpose and the actual expenditure for Regulatory Year 2011 will be assessed by the ERC during the annual rate reset for Regulatory Year 2013, when the actual expenditure levels will be known. Any difference between the estimate applied by the ERC for Regulatory Year 2011 and the actual expenditure for the same period will be corrected for. In the unlikely event that this difference is sufficiently large to have a material impact on the smoothing factor determined through Clause 4.15, the ERC may decide to treat this as cause for a re-opening event, which will be managed in terms of Article XII. Otherwise, any correction required will be handled during the Regulatory Reset Process for the next Regulatory Period, by adjusting the Net Efficiency Adjustment for that next period.

9.3 Mechanism for Carrying Over Net Efficiency Adjustments

9.3.1 The Net Efficiency Adjustment in respect of a Regulated Distribution System for a Regulatory Year *t* will be retained by the Regulated Entity that operates that Regulated Distribution System for a period of 4 years (where such Net Efficiency Adjustment for that Regulatory Year is a positive amount) and will be borne by that Regulated Entity for a period of 4 years (where such Net Efficiency Adjustment for that Regulatory Year is a negative amount). Accordingly, the Net Efficiency Adjustment in respect of a Regulated Distribution System for Regulatory Year *t* must be:

- (a) where such Net Efficiency Adjustment for Regulatory Year *t* is a positive amount - added to; or
- (b) where such Net Efficiency Adjustment for Regulatory Year *t* is a negative amount – subtracted from,

the allowed annual revenue requirement (calculated in accordance with Article V) for that Regulated Distribution System for each of the Regulatory Years in the next Regulatory Period up to and including that Regulatory Year which is the fourth Regulatory Year after Regulatory Year *t*.²²

For the avoidance of doubt, this means that the allowed annual revenue requirement for that Regulated Distribution System for any such Regulatory Year will be increased or decreased by the net sum of the Net Efficiency Adjustments in respect of that Regulated Distribution System for each of the Regulatory Years in the third and later Regulatory Periods that are to be added to or subtracted from the allowed annual revenue requirement for that Regulated

²² For example, if Regulatory Year *t* is 2013, then the fourth Regulatory Year after Regulatory Year *t* is Regulatory Year 2017.

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Distribution System for that Regulatory Year in accordance with this Section 9.3.1.

ARTICLE X

FORCE MAJEURE EVENT REGULATED PASS THROUGH

10.1 Force Majeure Event Pass Through

10.1.1 If a Force Majeure Event occurs, the Affected Regulated Entity may seek the ERC's approval to charge Customers of the relevant Regulated Distribution System, in addition to the maximum amounts that the Affected Regulated Entity is otherwise permitted to charge those Customers for Regulated Distribution Services in respect of that Regulated Distribution System pursuant to Articles III, IV or V (as applicable), an amount (Force Majeure Pass Through Amount) that is not greater than the Eligible Force Majeure Pass Through Amount (as calculated by the Affected Regulated Entity) in respect of that Force Majeure Event as at the date of the Force Majeure Event Claim (if any) given to the ERC pursuant to Section 10.2 in respect of that Force Majeure Event.

10.2 Claim for a Force Majeure Event

10.2.1 To seek the ERC's approval to pass through a Force Majeure Pass Through Amount under Section 10.1.1, the Affected Regulated Entity must give the ERC:

- (a) a Force Majeure Event Notice pursuant to Section 10.2.2 within 3 months of the relevant Force Majeure Event occurring; and
- (b) a Force Majeure Event Claim pursuant to Section 10.2.3 within 12 months of the relevant Force Majeure Event occurring.

10.2.2 A Force Majeure Event Notice must specify:

- (a) details of the Force Majeure Event concerned; and
- (b) the date the Force Majeure Event occurred.

10.2.3 A Force Majeure Event Claim must specify:

- (a) details of the Force Majeure Event concerned;
- (b) the date the Force Majeure Event occurred;
- (c) the increase in costs that the Affected Regulated Entity has actually incurred as at the date of the Force Majeure Event Claim:
 - in the distribution of electricity to Distribution Connection Points in respect of the relevant Regulated Distribution System; and
 - in complying with the provisions of any legislation, or of any rules, regulations or guidelines made under the EPIRA, including the IRR and the Distribution Code, which must be complied with in relation to the distribution of such electricity,

as a result of the occurrence of the Force Majeure Event;

- (d) the extent (if any) to which the Affected Regulated Entity has the benefit of any insurance against the consequences of the Force Majeure Event;
- (e) the Force Majeure Pass Through Amount the Affected Regulated Entity proposes in relation to the Force Majeure Event;

- (f) the basis on which the Affected Regulated Entity proposes to apply the Force Majeure Pass Through Amount to Customers of the relevant Regulated Distribution System, including the amount the Affected Regulated Entity proposes to apply to such Customers in each Regulatory Year; and
- (g) the date from, and the period over, which the Affected Regulated Entity proposes to apply the Force Majeure Pass Through Amount to Customers of the relevant Regulated Distribution System,

and must be accompanied by evidence of the increase in costs referred to in paragraph (c), and justification that such costs are reasonable and occur as a sole consequence of the Force Majeure Event.

10.2.4 If the amount which the Affected Regulated Entity proposes to apply to any Customer of the relevant Regulated Distribution System in any Regulatory Year, as specified in a Force Majeure Event Claim pursuant to Section 10.2.3(f), might result in the price for electricity paid by any End-user increasing in that Regulatory Year by more than the Force Majeure Threshold Amount (as defined in Section 10.2.6) in respect of that Regulatory Year, the ERC must publish a notice in a newspaper of general circulation in the area in which such End-users are located which:

- (a) sets out the details of the claimed Force Majeure Event and the date that Force Majeure Event was claimed to have occurred;
- (b) specifies the Force Majeure Pass Through Amount the Affected Regulated Entity proposes in relation to that Force Majeure Event and the basis on, date from and period over which the Affected Regulated Entity proposes to apply that Force Majeure Pass Through Amount to Customers of that Regulated Distribution System (including the amount the Affected Regulated Entity proposes to apply to such Customers in each Regulatory Year), in each case as set out in the Force Majeure Event Claim;
- (c) states that, if the Affected Regulated Entity's proposal is approved by the ERC, it might result in an increase in the price of electricity; and
- (d) invites interested persons to make submissions in relation to:
 - whether the claimed Force Majeure Event has occurred;
 - the amount that the ERC should determine as the Eligible Force Majeure Pass Through Amount in respect of the claimed Force Majeure Event;
 - the basis on, date from and period over which any Approved Force Majeure Pass Through Amount should be applied to Customers of that Regulated Distribution System; and
 - the effect of the claimed Force Majeure Event on the delivery of electricity to End-users.

10.2.5 The submissions referred to in Section 10.2.4 must be provided in writing or at such public consultations as the ERC may decide to convene for that purpose, but only those persons who make written submissions may participate in any such public consultations.

10.2.6 The Force Majeure Threshold Amount shall be set at the minimum of the following amounts:

- (a) the amount for which recovery would result in an average additional cost per kWh sold in a Regulated Distribution System that is equal or greater than 0.25% of the value of the maximum average price (MAP_t as defined in Section 4.2.1) for the year t in which the Force Majeure Event occurs; or
- (b) PhP 250 million divided by the total energy delivered (measured in kWh) to end-consumers through the Regulated Distribution System during the 12-month period prior to the force-majeure event.

10.3 Approval by ERC

10.3.1 If the ERC receives a Force Majeure Event Claim under Section 10.2.1(b) in relation to a Force Majeure Event, the ERC must decide whether the relevant Force Majeure Event occurred and, if the ERC decides the Force Majeure Event occurred, the ERC must decide:

- (a) the Eligible Force Majeure Pass Through Amount in respect of the Force Majeure Event;
- (b) the basis on which the Force Majeure Pass Through Amount proposed by the Affected Regulated Entity in relation to the Force Majeure Event or the Eligible Force Majeure Pass Through Amount in respect of the Force Majeure Event as determined by the ERC (whichever is the lesser) (the Approved Force Majeure Pass Through Amount) may be applied to Customers of the relevant Regulated Distribution System; and
- (c) the date from, and period over which the Approved Force Majeure Pass Through Amount in respect of the Force Majeure Event may be applied to such Customers,

and notify the Affected Regulated Entity in writing of the ERC's decision and the reasons for the ERC's decision.

10.3.2 If the ERC does not give a notice to the Affected Regulated Entity under Section 10.3.1 prior to the expiry of the Decision Period in respect of the Force Majeure Event Claim then, on the first Business Day after the expiry of that Decision Period, the ERC is deemed to have notified the Affected Regulated Entity of its decision that:

- (a) the Force Majeure Pass Through Amount proposed by the Affected Regulated Entity in relation to the relevant Force Majeure Event in the Force Majeure Event Claim is the Approved Force Majeure Pass Through Amount in respect of that Force Majeure Event; and
- (b) the basis on, date from and period over which that Approved Force Majeure Pass Through Amount may be applied to Customers of the relevant Regulated Distribution System are as specified in the Force Majeure Event Claim.

10.3.3 For the purposes of Section 10.3.2, the Decision Period in respect of a Force Majeure Event Claim is:

- (a) unless the ERC determines otherwise pursuant to paragraph (b), 90 Business Days after the ERC receives:
 - the Force Majeure Event Claim from the Affected Regulated Entity; and

- such evidence of the increase in costs referred to in Section 10.2.3(c) as is required by the ERC;
- (b) if the ERC convenes a public consultation or public consultations for the purpose of taking submissions in response to a notice published by the ERC pursuant to Section 10.2.4, such longer period as the ERC determines to be reasonable in the circumstances (in which case the ERC must give notice of that longer period to the Affected Regulated Entity within 5 Business Days after the last such public consultation).

10.4 Relevant Factors for ERC Consideration

10.4.1 In making a decision under Section 10.3.1, the ERC must take into account:

- (a) the matters and proposals set out in the Force Majeure Event Claim;
- (b) any submissions made to the ERC pursuant to Section 10.2.4;
- (c) the extent to which it would have been reasonable for the Affected Regulated Entity to have procured insurance against the consequences of the Force Majeure Event; and
- (d) any amount recoverable by the Affected Regulated Entity under insurances against the consequences of the Force Majeure Event and of which the Affected Regulated Entity has the benefit,

and, subject to the requirement that the Affected Regulated Entity is not to be compensated for losses against which it would have been reasonable for the Affected Regulated Entity to have been insured, or for losses to the extent they are able to be compensated for by claiming under insurances of which the Affected Regulated Entity has the benefit, the ERC must seek to ensure that the Affected Regulated Entity is fully (but not over) compensated for the increase in costs referred to in Section 10.2.3(c) to the extent that it was reasonable for the Affected Regulated Entity to incur those costs (or for such lesser amount as is proposed by the Affected Regulated Entity), taking into account:

- (e) the relative amounts of electricity distributed by the Affected Regulated Entity to each Customer of the relevant Regulated Distribution System;
- (f) the time cost of money based on the weighted average cost of capital (if any) determined by the ERC which applies for the purposes of these Rules in respect of the period over which the Approved Force Majeure Pass Through Amount is to be applied;
- (g) the basis on and period over which the Approved Force Majeure Pass Through Amount is to be applied;
- (h) any previous application of this Article X which has resulted in the Affected Regulated Entity recovering an amount either more or less than the amount required to fully (but not over) compensate it in respect of a previous Force Majeure Event in accordance with this Article X; and
- (i) any other factors the ERC considers relevant.

10.4.2 The ERC may retain an appropriately qualified expert or experts for the purpose of preparing a written report in respect of any of the matters that the ERC is required to decide pursuant to Section 10.3.1.

10.5 Application of Approved Force Majeure Pass Through Amount

10.5.1 The Affected Regulated Entity may, after:

- (a) receipt or deemed receipt of a notice under Section 10.3.1 or 10.3.2 allowing the Affected Regulated Entity to pass through an Approved Force Majeure Pass Through Amount; and
- (b) publishing a notice in a newspaper of general circulation that sets out:
 - the Approved Force Majeure Pass Through Amount which the ERC has approved or is deemed to have approved;
 - the circumstances giving rise to the Approved Force Majeure Pass Through Amount; and
 - the basis on, date from and period over which the Affected Regulated Entity will apply the Approved Force Majeure Pass Through Amount to Customers of the relevant Regulated Distribution System,

apply the Approved Force Majeure Pass Through Amount on the basis, from the date and over the period specified or deemed to be specified in the notice from the ERC.

10.5.2 The effect of an Approved Force Majeure Pass Through Amount must be:

- (a) shown on the bills of each affected Customer which are rendered in respect of any part of the period until the next Regulatory Period commences; or
- (b) otherwise notified to such Customers in a manner approved by the ERC.

10.6 Relevance of Approved Force Majeure Pass Through Amount

10.6.1 Subject to Sections 4.17.1, 4.17.2, 5.14.1 and 5.14.2, an Approved Force Majeure Pass Through Amount that may be applied by an Affected Regulated Entity under this Article X is not to be taken into account in the calculation of the maximum average price that the Affected Regulated Entity is permitted to charge for the provision by it of Regulated Distribution Services in respect of the relevant Regulated Distribution System, or in determining whether that price has been exceeded.

**ARTICLE XI
TAX EVENT REGULATED PASS THROUGH**

11.1 Tax Event Pass Through

11.1.1 If a Positive Tax Change Event occurs, the Affected Regulated Entity may seek the ERC's approval to charge Customers of the relevant Regulated Distribution System, in addition to the maximum amounts that the Affected Regulated Entity is otherwise permitted to charge those Customers for Regulated Distribution Services in respect of that Regulated Distribution System pursuant to Articles III, IV or V (as applicable), an amount (Positive Tax Pass Through Amount) that is not greater than the Eligible Tax Pass Through Amount (as calculated by the Affected Regulated Entity) in respect of that Tax Change Event.

11.1.2 If a Negative Tax Change Event occurs, the ERC may require an Affected Regulated Entity to pass through to Customers of the relevant Regulated Distribution System, as a reduction in the maximum amounts that the Regulated Entity is otherwise permitted to charge those Customers for Regulated Distribution Services in respect of that Regulated Distribution System pursuant to Articles III, IV or V (as applicable), an amount (Negative Tax Pass Through Amount) that is not greater than the Required Tax Pass Through Amount (as determined by the ERC) in respect of that Tax Change Event.

11.2 Claim for a Positive Tax Pass Through

11.2.1 To seek the ERC's approval to pass through a Positive Tax Pass Through Amount under Section 11.1.1, the Affected Regulated Entity must give the ERC, within 3 months of the relevant Tax Change Event occurring, a written statement which specifies:

- (a) details of the Tax Change Event concerned;
- (b) the date the Tax Change Event took effect;
- (c) the increase in costs in the distribution of electricity to Distribution Connection Points in respect of the relevant Regulated Distribution System that the Affected Regulated Entity has incurred and is likely to incur, until the end of the Regulatory Period in which the Tax Change Event occurs, as a result of the Tax Change Event;
- (d) the Positive Tax Pass Through Amount the Affected Regulated Entity proposes in relation to the Tax Change Event;
- (e) the basis on which the Affected Regulated Entity proposes to apply the Positive Tax Pass Through Amount to Customers of the relevant Regulated Distribution System, including the amount the Affected Regulated Entity proposes to apply to such Customers in each Regulatory Year; and
- (f) the date from, and period over, which the Affected Regulated Entity proposes to apply the Positive Tax Pass Through Amount to Customers of the relevant Regulated Distribution System,

and which is accompanied by evidence of the actual and likely increase in costs referred to in paragraph (c).

11.2.2 If the ERC receives a statement under Section 11.2.1 in relation to a Positive Tax Change Event, the ERC must decide whether that Tax Change Event occurred and, if the ERC decides the Tax Change Event occurred, the ERC must decide:

- (a) the Eligible Tax Pass Through Amount in respect of that Tax Change Event;
- (b) the basis on which the Positive Tax Pass Through Amount proposed by the Affected Regulated Entity in relation to that Tax Change Event or the Eligible Tax Pass Through Amount in respect of that Tax Change Event as determined by the ERC (whichever is the lesser) (the Approved Tax Pass Through Amount), may be applied to Customers of the relevant Regulated Distribution System; and
- (c) the date from, and period over, which the Approved Tax Pass Through Amount in respect of that Tax Change Event may be applied to such Customers,

and notify the Affected Regulated Entity in writing of the ERC's decision and the reasons for the ERC's decision.

11.2.3 If the ERC does not give a notice to the Affected Regulated Entity under Section 11.2.2 within 90 Business Days of receiving:

- (a) a statement from the Affected Regulated Entity under Section 11.2.1; and
- (b) such evidence of the increase in costs referred to in Section 11.2.1(c) as is required by the ERC,

then, on the 91st Business Day after receiving the Affected Regulated Entity's statement and that evidence, the ERC is deemed to have notified the Affected Regulated Entity of its decision that:

- (c) the Positive Tax Pass Through Amount proposed by the Affected Regulated Entity in relation to the Tax Change Event in the Affected Regulated Entity's statement is the Approved Tax Pass Through Amount in respect of that Tax Change Event; and
- (d) the basis on, date from and period over which that Approved Tax Pass Through Amount may be applied to Customers of the relevant Regulated Distribution System are as specified in the Affected Regulated Entity's statement.

11.3 Required Negative Tax Pass Through

11.3.1 If a Negative Tax Change Event occurs and the ERC decides to impose a requirement on an Affected Regulated Entity in relation to that Negative Tax Change Event as described in Section 11.1.2, the ERC must decide:

- (a) the Negative Tax Pass Through Amount in respect of that Tax Change Event;
- (b) the basis on which that Negative Tax Pass Through Amount must be applied to Customers of the relevant Regulated Distribution System; and
- (c) the date from, and period over, which the Negative Tax Pass Through Amount in respect of that Tax Change Event must be applied to such Customers,

and notify the Affected Regulated Entity in writing of the ERC's decision and the reasons for the ERC's decision.

11.3.2 A Regulated Entity must provide the ERC with such information as the ERC requires for the purpose of making a decision under Section 11.3.1 within the time specified by the ERC in a notice provided to the Regulated Entity by the ERC for that purpose.

11.4 Relevant Factors

11.4.1 In making a decision under Sections 11.2.2 or 11.3.1, the ERC must (in the case of a decision under Section 11.2.2) take into account the matters and proposals set out in the Affected Regulated Entity's statement and:

- (a) in the case of a decision under Section 11.2.2 - the ERC must ensure that the Affected Regulated Entity is fully (but not over) compensated for the actual and likely increase in costs referred to in Section 11.2.1(c) (or for such lesser amount as is proposed by the Affected Regulated Entity); and
- (b) in the case of a decision under Section 11.3.1 – the ERC must ensure that the aggregate amount that the Affected Regulated Entity is required to pass through to Customers of the relevant Regulated Distribution System is an amount that is not more than the costs that the Affected Regulated Entity has saved and is likely to save, until the end of the Regulatory Period in which the Negative Tax Change Event occurs, in the distribution of electricity to Distribution Connection Points in respect of that Regulated Distribution System as a result of the Negative Tax Change Event,

taking into account:

- (c) the relative amounts of electricity distributed by the Regulated Entity to each Customer of the relevant Regulated Distribution System;
- (d) the time cost of money based on the weighted average cost of capital (if any) determined by the ERC which applies for the purposes of these Rules in respect of the period over which the Approved Tax Pass Through Amount or the Negative Tax Pass Through Amount (as the case may be) is to be applied;
- (e) the basis on and period over which the Approved Tax Pass Through Amount or the Negative Tax Pass Through Amount (as the case may be) is to be applied;
- (f) any previous application of this Article XI in respect of the Affected Regulated Entity which has resulted in an Approved Tax Pass Through Amount or a Negative Tax Pass Through Amount in respect of a previous Tax Change Event being more or less than the amount which it should have been for the purposes of this Article XI;
- (g) any change in the way or rate at which another Tax is calculated, or the removal or imposition of another Tax, which, in the ERC's opinion, is complementary to the Tax Change Event concerned;
- (h) the effect of any other previous Tax Change Event that has occurred in respect of the Affected Regulated Entity since the later of:
 - the commencement of the Third Regulatory Period; and
 - the last decision relating to the Affected Regulated Entity which has been made under this Article XI in relation to a Tax Change Event; and
- (i) any other factors the ERC considers relevant.

11.5 Application of Approved Tax Pass Through Amount or Negative Tax Pass Through Amount

11.5.1 The Affected Regulated Entity may, after:

- (a) receipt or deemed receipt of a notice under Section 11.2.2 or 11.2.3 allowing the Affected Regulated Entity to pass through an Approved Tax Pass Through Amount; and
- (b) publishing a notice in a newspaper of general circulation that sets out:
 - the Approved Tax Pass Through Amount which the ERC has approved or is deemed to have approved;
 - the circumstances giving rise to the Approved Tax Pass Through Amount; and
 - the basis on, date from and period over which the Affected Regulated Entity will apply the Approved Tax Pass Through Amount to Customers of the relevant Regulated Distribution System,

apply the Approved Tax Pass Through Amount on the basis, from the date and over the period specified or deemed to be specified in the notice from the ERC.

11.5.2 An Affected Regulated Entity must, after receipt of a notice under Section 11.3.1 requiring the Affected Regulated Entity to pass through a Negative Tax Pass Through Amount to Customers, apply the Negative Tax Pass Through Amount on the basis, from the date and over the period specified in the notice from the ERC.

11.5.3 The effect of an Approved Tax Pass Through Amount or a Negative Tax Pass Through Amount must be:

- (a) shown on the bills of each affected Customer which are rendered in respect of any part of the period until the next Regulatory Period commences; or
- (b) otherwise notified to such Customers in a manner approved by the ERC.

11.6 Relevance of Approved Tax Pass Through Amount

11.6.1 Subject to Sections 4.17.1, 4.17.2, 5.14.1 and 5.14.2, an Approved Tax Pass Through Amount that may be applied by an Affected Regulated Entity under this Article XI is not to be taken into account in the calculation of the maximum average price that the Affected Regulated Entity is permitted to charge for the provision by it of Regulated Distribution Services in respect of the relevant Regulated Distribution System, or in determining whether that price has been exceeded.

ARTICLE XII
RE-OPENING AND ADJUSTMENT EVENTS

12.1 Increase in CPI – Maximum Annual Price Cap Re-opening

12.1.1 A Regulated Entity may apply to the ERC in writing for a change in the method used to calculate the Maximum Annual Price Cap for a Regulated Distribution System (MAP_i) as set out in Section 4.2.1, if the absolute value of the change in CPI between two consecutive Quarters within the then current Regulatory Period, as calculated pursuant to Section 12.1.6, is greater than 0.07.

12.1.2 Where a Regulated Entity makes an application pursuant to Section 12.1.1, it must include with that application the following information:

- (a) the raw data relied upon to demonstrate that the circumstance referred to in Section 12.1.1 has occurred; and
- (b) the calculations relied upon to demonstrate that the circumstance referred to in Section 12.1.1 has occurred.

12.1.3 Upon receiving an application under Section 12.1.1, the ERC must decide whether or not the circumstance referred to in Section 12.1.1 has occurred.

12.1.4 The ERC must notify the relevant Regulated Entity in writing of the ERC's decision under Section 12.1.3, and the reasons for that decision, by:

- (a) the 30th Business Day after the date the ERC receives the application from the Regulated Entity under Section 12.1.1; or
- (b) the day (if any) that the ERC notifies to the Regulated Entity is the extended date for making its decision (such extended date must be not later than the 30th Business Day after the end of the period referred to in Section 12.1.4(a) and such notice, which may only be given once, must be given prior to the end of the period referred to in Section 12.1.4(a)).

12.1.5 Where, following an application by a Regulated Entity under Section 12.1.1, the ERC decides that the circumstance referred to in Section 12.1.1 has occurred, the ERC must determine a new method for the purpose of calculating the Maximum Annual Price cap for the relevant Regulated Distribution System that is to apply for the relevant Regulatory Period by applying, to the extent reasonably practicable, the principles specified under Articles IV and V. The new method so determined applies for each succeeding Regulatory Year in the then current Regulatory Period, commencing with the Regulatory Year that commences after the ERC determines that new method.

12.1.6 For the purposes of this Section 12.1, the change in CPI between two consecutive Quarters within a Regulatory Period (DeltaCPI_{rp}) is calculated as follows:

$$\text{DeltaCPI}_{rp} = [\text{CPI}_{(Qj)} / \text{CPI}_{(Qj-1)}] - 1$$

Where:

CPI_(Qj) is the CPI for the second of the consecutive Quarters within the relevant Regulatory Period; and

$CPI_{(Qj-1)}$ is the CPI for the first of the consecutive Quarters within the relevant Regulatory Period.

12.2 Deferred Capital Expenditure on Major Projects – X factor adjustment for Third Regulatory Period

12.2.1 A Regulated Entity must promptly notify the ERC in writing if any capital expenditure for a Major Project, which is forecasted to be undertaken in the capital expenditure program that is approved by the ERC under Section 4.12.5 for a Regulated Distribution System that is operated by the Regulated Entity, has not been substantially undertaken within 18 months of the time it was so forecasted to be undertaken.

12.2.2 If at any time the ERC determines that a Major Project, which is forecasted to be undertaken in the capital expenditure program that is approved by the ERC under Section 4.12.5 for a Regulated Distribution System that is operated by a Regulated Entity, has not been substantially undertaken within 18 months of the time it was so forecasted to be undertaken:

- (a) the ERC must promptly notify the Regulated Entity in writing of its determination;
- (b) after taking into account any submissions made by the Regulated Entity, the ERC may determine a new value for the X factor in the formula for the calculation of the Maximum Annual Price cap for that Regulated Distribution System as set out in Section 4.2.1 by recalculating the X factor:
 - based on the exclusion from that capital expenditure program of all of the capital expenditure which is forecasted to be undertaken in that program for the Major Project;
 - disallowing excess revenue earned by a Regulated Entity on capital expenditure that has been deferred but which has been included in the forecasts used for the original calculation of the X factor, as described in Section 12.2.3 below; and
 - so as to recognize the extent to which the previous X factor was set on the basis of the capital expenditure that is excluded under paragraph (i).

Any X factor which is recalculated under this Section 12.2.2 applies for each succeeding Regulatory Year in the then current Regulatory Period, commencing with the Regulatory Year that commences after the ERC recalculates that X factor, unless the ERC (acting pursuant to this Article XII) subsequently determines a new value for the X factor in the formula for the calculation of the Maximum Annual Price cap for that Regulated Distribution System, or a new method for the purpose of calculating that Maximum Annual Price cap, that is to apply for such Regulatory Years; or

- (c) alternatively, during the Regulatory Reset for the Regulatory Period following the one in which a Major Project has been deferred, the ERC may calculate the excess revenue that was earned by a Regulated Entity on the capital value of the deferred project and treat this as an over-recovery by the Regulated Entity, that will be recovered during the next Regulatory Period. Such over-recovery amount will then be deducted from the allowed revenue requirement for the first

Regulatory Year of the following Regulatory Period (ARR₂₀₁₂ as per Section 4.15.2).

12.2.3 Excess revenue earned by a Regulated Entity as a result of delaying a Major Project will be calculated based on the period for which a Major Project was deferred and the income earned by the Regulated Entity on the value of the Major Project during that period. The excess revenue calculation will take into account the return on the deferred forecast capital expenditure associated with the Major Project and the allowance made for regulatory depreciation on this capital expenditure, as was included as part of the building blocks used for the calculation of the smoothed price path prior to the start of the Regulatory Period in which the Major Project was estimated to be implemented, converted to present value at the time of the calculation, using the following formula:

$$ER_n = (WACC \times CV_n \times \frac{Def_n}{12} + Depn_n)(1 + WACC)^{\frac{Def_n}{12}}$$

where,

ER_n = excess revenue earned related to deferred Major Project n;

WACC = Regulatory WACC as described in Section 11 for the period of the deferral. If the WACC for a Regulated Entity has changed during the deferral period, as described in Section 4.11.13, it will be calculated at the weighted average for the WACC for the total deferral period, where the weighting will be according to the time for which the different WACC figures applied;

CV_n = estimated capital value for deferred Major Project n that was included in the approved capital expenditure forecast for the current Regulatory Period;

Def_n = the time with which the Major Project n has been deferred (measured in months); and

$Depn_n$ = regulatory depreciation on the capital expenditure for Major Project n that was included in the approved depreciation forecast for the current Regulatory Period, over the time Def_n .

In recalculating the X factor as described in Section 12.2.2(b), the excess revenue will be deducted from the allowed revenue requirements for the first of the remaining years of the Regulatory Period. Alternatively, the excess amount will be deducted during the next Regulatory Period, as described in Section 12.2.2(c).

12.2.4 If a Major Project is deferred into the next Regulatory Period, regardless of the period of such deferral, Sections 12.2.2 (c) and 12.2.3 will apply. This implies that any Major Project deferred to a next Regulatory Period will be excluded from a Regulated Entity's construction program, unless it is re-applied for. Should the Regulated Entity wish to still proceed with the same Major Project during the next Regulatory Period, this project should be included in the forecasts for capital

expenditure submitted by the Regulated Entity for the next Regulatory Period, in terms of Section 4.12.

- 12.2.5 In the case that a Regulated Entity wishes to defer a Major Project into the next Regulatory Period, written notice of this intention must be provided to the ERC prior to the date at which a Regulated Entity submits its application for capital expenditure for the next Regulatory Period.

12.3 Major changes to electricity consumption patterns

- 12.3.1 At each annual rate reset, prior to the start of a next Regulatory Year (Regulatory Year t), the actual electricity consumption in a Regulated Distribution System will be compared with the forecast consumption figures approved by the ERC in its final determination on the price control arrangement for the Third Regulatory Period.

- 12.3.2 The comparison of actual and forecast consumption (DeltakWh_t) for Regulatory Year t will be as follows:

$$\text{DeltakWh}_t = \{ \text{Absolute value of } [(CQ_{t-1} - RQ_{t-1}) / (CQ_{t-1})] \} \times 100$$

where

CQ_{t-1} = The total amount of energy (expressed in kWh) delivered through the relevant Regulated Distribution System, during the 12-month period ending on December 31 in Regulatory Year t-1, to Distribution Connection Points in respect of that Regulated Distribution System

RQ_{t-1} = The forecast amount of energy (expressed in kWh) delivered through the relevant Regulated Distribution System, during the 12-month period ending on December 31 in Regulatory Year t-1, to Distribution Connection Points in respect of that Regulated Distribution System, determined as follows:

$$RQ_{t-1} = 0.5(FQ_{t-2} + FQ_{t-1})$$

where

FQ_{t-1} = The total amount of energy (expressed in kWh) forecast by the ERC in its final determination on the price control arrangements for the Third Regulatory Period to be delivered through the relevant Regulated Distribution System, during Regulatory Year t-1, to Connection Points in respect of that Regulated Distribution System; and

FQ_{t-2} = The total amount of energy (expressed in kWh) forecast by the ERC in its final determination on the price control arrangements for the Third Regulatory Period to be delivered through the relevant Regulated Distribution System, during Regulatory Year t-2, to Distribution Connection Points in respect of that Regulated Distribution System.

- 12.3.3 If $\text{DeltakWh}_t > 15\%$, then the ERC will recalculate the forecast energy consumption figures for the Regulated Entity for the remainder of the Regulatory Period, including

Regulatory Year t. Based on these new consumption figures, the ERC will then determine a new value for the X factor that will apply to the Regulated Entity for the remainder of the Regulatory Period.

12.3.4 Any X factor which is recalculated under this Section 12.3.3 applies for each succeeding Regulatory Year in the then current Regulatory Period for the Regulated Entity for which it was calculated. The new energy consumption forecasts calculated by the ERC will also remain in place for each succeeding Regulatory Year and will form the basis against which similar comparisons will be carried out at future annual rate resets for that Regulated Entity.

12.4 Major Unforecasted Acquisitions – X factor adjustment for Third Regulatory Period

12.4.1 Where:

- (a) a Regulated Entity has acquired assets which, following such acquisition, form part of a Regulated Distribution System that is operated by the Regulated Entity;
- (b) that acquisition (referred to in this Section 12.4.1 as the "relevant acquisition") occurs during the Third Regulatory Period;
- (c) the value of the assets so acquired, together with the aggregate value of all other assets which form part of that Regulated Distribution System and which have previously been acquired by the Regulated Entity during the Third Regulatory Period, is greater than the lesser of PhP 150 Million or 3% of the value of all assets that, at the time of the relevant acquisition, are used by the Regulated Entity to provide Regulated Distribution Services in respect of that Regulated Distribution System; and
- (d) the acquisition of the assets referred to in paragraph (c) (i.e. the assets which are the subject of the relevant acquisition as well as those which have previously been acquired by the Regulated Entity during the Third Regulatory Period):
 - is not included by the ERC in the calculation of the Regulatory Asset Base for that Regulated Distribution System for any Regulatory Year in the Third Regulatory Period, pursuant to Section 4.9.1, for the purposes of the Regulatory Reset Process for the Third Regulatory Period under Article VII; or
 - is included by the ERC in the calculation of the Regulatory Asset Base for that Regulated Distribution System for any Regulatory Year in the Third Regulatory Period, pursuant to Section 4.9.1, for the purposes of the Regulatory Reset Process for the Third Regulatory Period under Article VII, but is for an amount that is:
 - greater than 150%; or
 - less than 60%,
 - of the forecast amount included for that purpose by the ERC in the calculation of that Regulatory Asset Base,

then:

- (e) where paragraphs (a), (b), (c) and (d)(i) or (d)(ii)(A) apply, the Regulated Entity may apply to the ERC in writing for the determination of a new value of the X factor in the formula for the calculation of the Maximum Annual Price cap for that Regulated Distribution System; or
- (f) where paragraphs (a), (b), (c) and (d)(ii)(B) apply, the Regulated Entity must promptly notify the ERC in writing of the application of those paragraphs.

12.4.2 Where a Regulated Entity makes an application pursuant to Section 12.4.1(e), it must include with that application information that demonstrates that the circumstances referred to in Section 12.4.1(a), (b), (c) and (d)(i) or (d)(ii)(A) have occurred.

12.4.3 Upon receiving an application under Section 12.4.1(e), the ERC must decide whether or not the circumstances referred to in Section 12.4.1(a), (b), (c) and (d)(i) or (d)(ii)(A) have occurred.

12.4.4 The ERC must notify the relevant Regulated Entity in writing of the ERC's decision under Section 12.4.3, and the reasons for that decision, by:

- (a) the 30th Business Day after the date the ERC receives the application from the Regulated Entity under Section 12.4.1(e); or
- (b) the day (if any) that the ERC notifies to the Regulated Entity is the extended date for making its decision (such extended date must be not later than the 30th Business Day after the end of the period referred to in Section 12.4.4(a) and such notice, which may only be given once, must be given prior to the end of the period referred to in Section 12.4.4(a)).

12.4.5 If at any time the ERC determines that the circumstances referred to in Section 12.4.1(a), (b), (c) and (d)(ii)(B) have occurred, the ERC must promptly notify the relevant Regulated Entity in writing of its determination.

12.4.6 If:

- (a) following an application by a Regulated Entity under Section 12.4.1(e), the ERC decides that the circumstances referred to in Section 12.4.1(a), (b), (c) and (d)(i) or (d)(ii)(A) have occurred – the ERC must; or

- (b) at any time the ERC determines that the circumstances referred to in Section 12.4.1(a), (b), (c) and (d)(ii)(B) have occurred – the ERC may,

in either case after taking into account any submissions made by the Regulated Entity, determine a new value for the X factor in the formula for the calculation of the Maximum Annual Price cap for that Regulated Distribution System as set out in Section 4.2.1 by recalculating the X factor:

- (c) based on:

- where Section 12.4.1(a), (b), (c) and (d)(i) apply, the inclusion of the value of the assets which have been so acquired;
- where Section 12.4.1(a), (b), (c) and (d)(ii)(A) or (d)(ii)(B) apply, the amount for which the assets were acquired; and

- (d) so as to recognize the extent to which the previous X factor was set on the basis of:

- in the case of paragraph (c)(i), those assets not being so acquired by the Regulated Entity; and
- in the case of paragraph (c)(ii), those assets being acquired by the Regulated Entity for a different amount.

Any X factor which is recalculated under this Section 12.4.6 applies for each succeeding Regulatory Year in the then current Regulatory Period, commencing with the Regulatory Year that commences after the ERC recalculates that X factor, unless the ERC (acting pursuant to this Article XII) subsequently determines a new value for the X factor in the formula for the calculation of the Maximum Annual Price cap for that Regulated Distribution System, or a new method for the purpose of calculating that Maximum Annual Price cap, that is to apply for such Regulatory Years.

12.4.7 Regulatory Entities should note that in terms of Commonwealth Act 146 all major capital works need to be approved by the ERC prior to commencing with such works. This implies that, even if a Regulated Entity decide not to notify the ERC of an unforeseen acquisition or excess expenditure in terms of Section 12.4.1(e) for the purpose of recalculating the X-factor for the remainder of the Regulatory Period, it would still require prior approval from the ERC before embarking on the project.

12.5 PhP/\$US exchange rate adjustment

12.5.1 If the PhP/\$US exchange rate for a Quarter within the Third Regulatory Period is less than 90%, or more than 110%, of the PhP/\$US exchange rate for that Quarter which is approved by the ERC for the purposes of the capital expenditure program that is approved by the ERC under Section 4.12.5 for a Regulated Distribution System (see also Section 12.5.2), then this Section 12.5.1 applies in respect of the Regulatory Year t that immediately follows the Regulatory Year in which that Quarter occurs (Section 4.5 specifies the consequences of Section 12.5.1 so applying).

12.5.2 For the purposes of Section 12.5.1:

- (a) both the first-mentioned and the second-mentioned PhP/\$US exchange rates must be expressed as PhP/US\$1 (for example, if PhP50 can purchase US\$1, then the relevant PhP/\$US exchange rate is 50); and
- (b) the first-mentioned PhP/\$US exchange rate must be calculated in a manner, and be of a kind, that is substantially comparable to the manner of calculation, and kind, of the second-mentioned PhP/\$US exchange rate.

12.6 Weighted average cost of capital adjustment

12.6.1 At the time of making its final determination on the price-control arrangements for each new Entry Group, in accordance with Section 4.11 the ERC will determine the appropriate rate of return for the return (WACC) on capital building block that will be included in the allowed revenue requirement for that Entry Group. To ensure reasonable consistency between the rates of return applied for different Entry Groups, the ERC will at each Entry Point also review the WACC used for earlier Entry Groups. The difference between the newly determined WACC and the WACC used for each previous Entry Group will therefore be calculated.

12.6.2 The difference between the newly determined WACC at a new Entry Point and the WACC used for a previous Entry Group is calculated as follows:

$\Delta WACC = \text{Absolute value of } [(WACC_{\text{new}} - WACC_{\text{current}}) / (WACC_{\text{current}})] \times 100$

where :

$WACC_{\text{new}}$ = The newly determined WACC at the latest Entry Point

$WACC_{\text{current}}$ = The current WACC applying to a previous Entry Group

12.6.3 If $\Delta WACC \geq 10\%$ for any previous Entry Group, then the WACC for that previous Entry Group will be adjusted to the most recent WACC determined by the ERC. The ERC will then, for that previous Entry Group, determine a new value for the X factor in the formula for the calculation of the maximum average price cap for that Regulated Distribution System as set out in Section 4.2.1. This will take into account the impact of the change in the allowed WACC on the various parameters on which the X-factor is based.

12.6.4 Any X factor which is recalculated under this Section 12.6.3 applies for each succeeding Regulatory Year in the then current Regulatory Period for the Entry Group for which it was calculated, commencing with the Regulatory Year that commences after the ERC recalculates that X factor.

12.7 Operating and maintenance expenditure adjustment

12.7.1 Where:

- (a) a Regulated Entity has incurred operating and maintenance expenditure on a Regulated Distribution System that it operates;
- (b) that expenditure (referred to in this Section 12.7.1 as the "relevant expenditure") occurs during the Third Regulatory Period;
- (c) the relevant expenditure referred to in paragraph (b):
 - pursuant to Section 4.13.5, for the purpose of the Regulatory Reset Process for the Third Regulatory Period under Article VII and results in a total Operating and Maintenance expenditure that is greater than 125% of the full Operating and Maintenance amount included for that Regulatory Year by the ERC in the final determination of the price-control arrangements for the Third Regulatory Period, it is not included by the ERC in the calculation of the Operating and Maintenance expenditure allowed for that Regulated Distribution System for any Regulatory Year in the Third Regulatory Period, or
 - for the purpose of the Regulatory Reset Process for the Third Regulatory Period under Article VII, it is included by the ERC in the Operating and Maintenance expenditure for that Regulated Distribution System for any Regulatory Year in the Third Regulatory Period, but varies to the extent that total Operating and Maintenance expenditure is:
 - (A) greater than 125%; or
 - (B) less than 75%,
of the forecast amount included for that Regulatory Year purpose by the ERC in the final determination of the price-control arrangements for the Third Regulatory Period,

then:

- (d) where paragraphs (a), (b) and (c)(i) or (c)(ii)(A) apply, the Regulated Entity may apply to the ERC in writing for the determination of a new value of the X factor in the formula for the calculation of the Maximum Annual Price cap for that Regulated Distribution System; or
- (e) where paragraphs (a), (b) and (c)(ii)(B) apply, the Regulated Entity must promptly notify the ERC in writing of the application of those paragraphs.

12.7.2 Where a Regulated Entity makes an application pursuant to Section 12.7.1(a), it must include with that application information that demonstrates that the circumstances referred to in Section 12.7.1(a), (b) and (c)(i) or (c)(ii)(A) have occurred.

12.7.3 Upon receiving an application under Section 12.7.1(e), the ERC must decide whether or not the circumstances referred to in Section 12.7.1(a), (b) and (c)(i) or (c)(ii)(A) have occurred.

12.7.4 The ERC must notify the relevant Regulated Entity in writing of the ERC's decision under Section 12.7.3, and the reasons for that decision, by:

- (a) the 30th Business Day after the date the ERC receives the application from the Regulated Entity under Section 12.7.1(d); or
- (b) the day (if any) that the ERC notifies to the Regulated Entity is the extended date for making its decision (such extended date must be not later than the 30th Business Day after the end of the period referred to in Section 12.7.4(a) and such notice, which may only be given once, must be given prior to the end of the period referred to in Section 12.7.4(a)).

12.7.5 If at any time the ERC determines that the circumstances referred to in Section 12.7.1(a), (b) and (c)(ii)(B) have occurred, the ERC must promptly notify the relevant Regulated Entity in writing of its determination.

12.7.6 If:

- (a) following an application by a Regulated Entity under Section 12.7.1(d), the ERC decides that the circumstances referred to in Section 12.7.1(a), (b) and (c)(i) or (c)(ii)(A) have occurred – the ERC must; or
- (b) at any time the ERC determines that the circumstances referred to in Section 12.7.1(a), (b) and (c)(ii)(B) have occurred – the ERC may,

in either case after taking into account any submissions made by the Regulated Entity, determine a new value for the X factor in the formula for the calculation of the Maximum Annual Price cap for that Regulated Distribution System as set out in Section 4.7.1 by recalculating the X factor:

- (c) based on:
 - where Section 12.7.1(a), (b), (c)(i) and (c)(ii)(A) apply, the inclusion of the additional expenditure so identified;
 - where Section 12.4.1(a), (b) and (c)(ii)(B) apply, the reduction of the excess expenditure so identified; and
- (d) so as to recognize the extent to which the previous X factor was set on the basis of:

- in the case of paragraph (c)(i), that extra Operating and Maintenance expenditure not being incurred by the Regulated Entity; and
 - in the case of paragraph (c)(ii), the variances in the Operating and Maintenance expenditure from what was originally approved by the ERC.
- (e) Any X factor which is recalculated under this Section 12.4.6 applies for each succeeding Regulatory Year in the then current Regulatory Period, commencing with the Regulatory Year that commences after the ERC recalculates that X factor, unless the ERC (acting pursuant to this Article XII) subsequently determines a new value for the X factor in the formula for the calculation of the Maximum Annual Price cap for that Regulated Distribution System, or a new method for the purpose of calculating that Maximum Annual Price cap, that is to apply for such Regulatory Years.

12.8 Procedure for events leading to an adjustment of rates

12.8.1 Section 4(e), Rule 3 of the Implementing Rules and Regulations (IRR) of R.A. 9136 should be strictly adhered to in all applications filed with the Commission for rates and other relief affecting consumers. Any application that would lead to revenue recovery on the part of Regulated Entity and therefore give rise to an adjustment in rates for consumers (which could be an increase or decrease), including applications for applying pass-through costs and re-opening events for recalculating the X-factor, should comply with Section 4(e), Rule 3 of the IRR. In this light, the following procedure will be applied to any applications filed by Regulated Entities that may give rise to rate adjustments for consumers:

- (a) filings by Regulated Entities of applications for recovery should be made within the times prescribed in Articles X, XI or XII and in compliance with the pre-filing requirements set forth in Section 4(e), Rule 3 of the IRR of R.A. 9136;
- (b) the ERC shall set a date for the public hearing of such filings not later than thirty (30) days after receipt of the filing;
- (c) all memorandums, comments, position papers on the application, together with all supporting documentation and testimonial evidences in affidavit form associated with the public hearing shall be submitted within a period of one month from the date of the hearing; and
- (d) a final resolution on the application for recovery shall be given not later than six months from the filing of the application.

**ARTICLE XIII
DECISION REVOCATION AND NOTICES**

13.1 Limited Decision Revocation Arrangements

13.1.1 If the ERC has made a decision under these Rules and later concludes that the decision was made on the basis of information provided to the ERC that was false or misleading in a material particular, or on the basis of analysis provided to the ERC by a Regulated Entity which incorporated a material calculation error, then, subject to Section 13.1.2, the ERC may revoke the decision and make a new decision in substitution for the revoked decision.

13.1.2 Before the ERC revokes and substitutes a decision pursuant to Section 13.1.1, the ERC must first:

- (a) notify each Regulated Entity in writing to which the decision applies of:
 - the proposed revocation;
 - the false or misleading information or the calculation error;
 - the information required from such Regulated Entities to assist the ERC in making a new decision (if necessary); and
 - the proposed process and time frame for making any new decision (including the proposed date of effect of the revocation and new decision);
- (b) allow each Regulated Entity to which the decision applies a reasonable period to make submissions to the ERC, not exceeding 30 Business Days, regarding the proposals referred to in paragraph (a) (including submissions as to whether the original decision was based on information that was false or misleading in a material particular or on a material calculation error); and
- (c) take into account any matters contained in submissions made pursuant to paragraph (b).

13.1.3 A new decision made under Section 13.1.1 must only differ from the revoked decision to the extent necessary to correct for:

- (a) the false or misleading information (if any) on which the revoked decision was based;
- (b) the calculation error (if any) on which the revoked decision was based; and
- (c) the application of the revoked decision during the period in which that decision was in effect.

13.1.4 The provision of false or misleading information to the ERC is a breach of these Rules and the ERC may impose a fine or penalty under Section 43(l) of the EPIRA for such a breach.

13.2 Modification of Time Periods

13.2.1 The ERC may, by written notice to a Regulated Entity and upon a request for such extension being made in writing by the Regulated Entity, extend:

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- (a) any time prescribed by these Rules as the time by which a thing required to be done by the Regulated Entity must be done; or
- (b) any period prescribed by these Rules as the period within which a thing required to be done by the Regulated Entity must be done.

ARTICLE XIV
EXPERTS AND CONSULTANTS

14.1 Engagement of experts and consultants

14.1.1 Where these Rules confer on the ERC the right or obligation to retain a Regulatory Reset Expert in relation to a matter pursuant to this Article XIV, that Regulatory Reset Expert must be an expert who:

- (a) has expertise in one or more of the following areas:
 - asset valuation;
 - distribution system design, construction, maintenance and operation;
 - load flow modeling of electricity distribution networks;
 - distribution network benchmark service performance;
 - accounting;
 - corporate finance, financial modeling and pricing;
 - economic analysis and economic modeling;
 - fire inspection;
 - insurance and claims risk adjustment;
 - such other areas as the ERC considers appropriate;
- (b) in respect of its relevant area of expertise, satisfies the applicable criteria that are specified in Appendix C or that are otherwise notified in writing by the ERC to each Regulated Entity from time to time; and
- (c) has no commercial or pecuniary relationship with a Regulated Entity at a financial, management or board level.

14.1.2 Nothing in Section 14.1.1 precludes the ERC from retaining any other expert or consultant for the purpose of assisting it in connection with any matter arising under these Rules in relation to a particular Regulated Entity or a particular Regulated Distribution System (other than in circumstances where these Rules entitle or oblige the ERC to retain a Regulatory Reset Expert pursuant to this Article XIV) and, if the ERC retains such an expert or consultant, the reasonable costs of that expert or consultation must, if and as so required by the ERC, be paid to the ERC, or the expert or consultant, by the relevant Regulated Entity or the Regulated Entity that operates the relevant Regulated Distribution System.

14.2 Cooperation with experts and consultants

14.2.1 Where the ERC retains any expert or consultant (including a Regulatory Reset Expert) for the purpose of assisting it in connection with any matter arising under these Rules, each Regulated Entity must provide that expert or consultant with such access to the Regulated Entity's systems, records, infrastructure and personnel as the expert or consultant requires to enable it to successfully complete its work for the ERC and must otherwise fully cooperate with the expert or consultant for that purpose.

14.3 Report of expert or consultant

14.3.1 Where:

- (a) a report is provided to the ERC:
 - by an expert or consultant who is retained by the ERC (including a Regulatory Reset Expert); or
 - by an independent appraisal company pursuant to Section 4.8; and
- (b) that report contains information of a confidential nature relating to a Regulated Entity,
 - the ERC may only disclose that information:
- (c) to the Regulated Entity; or
- (d) a person other than the Regulated Entity if:
 - the ERC has first given the Regulated Entity 10 days' written notice of its intention to disclose that information, together with a copy of the intended disclosure; and
 - the ERC has taken such steps as it considers to be appropriate (after considering any submissions that the Regulated Entity has made to the ERC during that 10 day period) to mask, excise or otherwise modify information contained in the intended disclosure for the purpose of protecting the confidentiality of that information.

14.4 Payment of fees of Regulatory Reset Experts

14.4.1 Where these Rules confer on the ERC the right or obligation to retain a Regulatory Reset Expert in relation to a matter pursuant to this Article XIV, the costs of that Regulatory Reset Expert must be borne by all the Regulated Entities that are participating or will be participating in performance based regulation by June 2011. The ERC will inform all Regulated Entities of its intention to retain a Regulatory Reset Expert for particular services and instruct the Regulated Entities to enter into a contract with this Regulatory Reset Expert for the provision of these services. The form of contract will be pre-approved by the ERC after consultation with all Regulated Entities and will describe the scope of work required, other support service included in the contract and the terms and conditions for providing the services, including the payment terms. While the ERC will have certain rights and obligation under such a contract, it will not be a contractual party of any such contract.

14.4.2 Each Regulated Entity must bear a proportion of the costs of the Regulatory Reset Expert (PC) as described in each contract. These costs will be expressed in decimal terms, and will be calculated in accordance with the following formula:

$$PC = \frac{AQ}{TAQ}$$

Where:

AQ = the total amount of energy (expressed in kWh) delivered through the relevant Regulated Distribution System operated by the Regulated Entity, during the Measurement Period for the Relevant Regulatory

Period, and sold to Distribution Connection Points in respect of that Regulated Distribution System, such amount of energy:

- (a) being determined in a manner that is approved for this purpose by the ERC; and
- (b) as so determined being audited to the satisfaction of the ERC by a person that is approved for this purpose by the ERC; and

TAQ = the sum of the amounts denoted "AQ" for all of the Regulated Entities.

- (a) For future Regulatory Periods, the Measurement Period will be the average of the last three calendar years before the start of the Regulatory Reset Period for the first Entry Group. This also applies to the Third Regulatory Period, for which the Measurement Period will be calendar years 2006 to 2008. All future costs for Regulatory Reset Experts that are incurred six months or more after the end of a new Measurement Period, will be divided proportionally to the energy consumption for that new Measurement Period, regardless of whether such costs may still reflect services related to the previous Regulatory Period for some of the later Entry Groups.
- (b) The proportional cost sharing for the Third Regulatory Period, based on the 2006-2008 Measurement Period, is indicated in Appendix F.

14.4.3 Each Regulated Entity must pay to the ERC, or (if so required by the ERC) to the Regulatory Reset Expert, the amount of such of the costs of the Regulatory Reset Expert as it is required to bear in accordance with Section 14.4.1 and 14.4.2 within 30 days of receiving a written statement from the ERC, or an invoice from the Regulatory Reset Expert that has been certified as correct by the ERC, which:

- (a) sets out that amount; and
- (b) shows how that amount was calculated or provide reference to the contractual agreement where it is shown how that amount is calculated.

Unless otherwise agreed with a Regulated Entity, the only costs that may be included in a statement that is given by the ERC under this Section 14.4.3 are those costs in respect of which the ERC has received a written invoice from the Regulatory Reset Expert. Nothing in this Section 14.4 precludes the ERC from giving successive statements or approving successive invoices under this Section 14.4 in respect of the costs of a Regulatory Reset Expert in relation to work performed, or to be performed, by that Regulatory Reset Expert (e.g. as where the ERC is invoiced by the Regulatory Reset Expert for a deposit or an installment or progress payment).

14.4.4 To ease the administrative burden on Regulatory Reset Experts, Regulated Entities may be requested to be represented as a group for the purposes of entering into a contract with a Regulatory Reset Expert for particular services.²³ Such an arrangement will however not diminish or change the responsibilities of any Regulated Entity under this Section 14.4. The proportional payment requirements

²³ At the date of issuing these Rules, 18 of the Regulated Entities to which performance based regulation applies or will apply are contractually represented by the Private Electric Power Operators Association Inc. (PEPOA).

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will also remain intact and the required contribution from each Regulated Entity will be indicated in the statement from the ERC or invoice from the Regulatory Reset Expert.

14.4.5 If a Regulated Entity fails to pay any amount that is required to be paid to the ERC or a Regulatory Reset Expert in accordance with Section 14.4.1 and 14.4.2, that Regulated Entity must pay interest to the ERC or the Regulatory Reset Expert, at the Default Rate applicable at the time at which the payment was due, on the amount which the Regulated Entity has failed to pay from the time the payment fell due until that amount has been paid in full.

(a) the "Default Rate" means the sum of 4% and the simple average of the monthly 180 day weighted-average Manila Reference Rate in nominal percent per annum terms published by Bangko Sentral ng Pilipinas for the date of the ERC's statement or the Regulatory Reset Expert's invoice.

Pasig City, Philippines,

ZENAIDA G. CRUZ-DUCUT

Chairperson

RAUF A. TAN

Commissioner

ALEJANDRO Z. BARIN

Commissioner

MARIA TERESA A.R. CASTAÑEDA

Commissioner

JOSE C. REYES

Commissioner

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APPENDIX A
QUALIFIED FRANCHISE AREAS

Qualified Franchise Area	Regulated Entity
FIRST ENTRY GROUP	
City of Cagayan de Oro and Municipalities of Tagoloan, Jasaan and Villaneuva, all in Misamis Oriental, Mindanao	Cagayan de Oro Electric Power & Light Company, Inc (CEPALCO)
Dagupan City, Calasiao, Sta. Barbara, San Jacinto, San Fabian (Luzon), Manaoag and barangays Bolingit and Cruz of San Carlos City.	Dagupan Electric Corporation (DECORP)
Metro Manila, entire provinces of Bulacan, Cavite and Rizal, part of the provinces of Batangas, Laguna and Quezon, barangays in the province of Pampanga	Manila Electric Company (MERALCO)
SECOND ENTRY GROUP	
Cotabato City, Parts of the Municipalities of Datu Odin Sinsuat (formerly Piña-ig) and Sultan Kudarat Province	Cotobato Light & Power Company (CLPC)
City of Iligan in the Province of Lanao Del Norte	Iligan Light & Power, Incorporated (ILPI)
Lapu-Lapu City, Olango Island and Municipality of Cordova	Mactan Electric Company (MECO)
THIRD ENTRY GROUP	
City of Cabanatuan in the Province of Nueva Ecija	Cabanatuan Electric Corporation (CELCOR)
Municipality of Ibaan, Barangay Salaban in the Municipality of San Jose, Barangay Pag-asa in the Municipality of Taysan and Barangay Adya in Lipa City, all in the Province of Batangas	Ibaan Electric and Engineering Corporation (IEEC)
Cities of Davao and Panabo and Municipalities of Carmen, Dujali and Sto. Tomas in Davao Del Norte	Davao Light and Power Company (DLPC)
San Fernando City, Municipalities of San Juan and Bauang, all in the Province of La Union	La Union Electric Company (LUECO)
City of Tarlac, Province of Tarlac	Tarlac Electric, Incorporated (TEI)

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Cities of Cebu, Mandaue and Talisay and Municipalities of Consolacion, Lilo-an, Minglanilla, Naga and San Fernando, all in the Province of Cebu	Visayan Electric Company (VECO)
FOURTH ENTRY GROUP	
City of Angeles and its suburbs in the Province of Pampanga	Angeles Electric Corporation (AEC)
Tagbilaran City in the Province of Bohol	Bohol Light Company, Incorporated (BLCI)
Clark Economic Zone (composed of Clark Freeport Zone and Clark Sub-zone), Pampanga	Clark Electric Distribution Corporation (CEDC)
Iloilo City and Municipalities of Jaro, Lapuz, Arevalo, Lapaz, Molo and Mandurriao, all in the Province of Iloilo	Panay Electric Company (PECO)
Subic Economic Zone - Subic Bay Metropolitan Authority (SBMA)	Subic Enerzone Corporation (SEZC)
City of San Fernando, Municipality of Floridablanca, except Basa Resettlement, and Barangays Talang and Ligaya in the Municipality of Guagua, all in the Province of Pampanga	San Fernando Electric Light and Power Company (SFELAPCO)

APPENDIX B
PERFORMANCE INCENTIVE SCHEME

B1. OVERVIEW

The performance incentive scheme that will apply for the Third Regulatory Period and subsequent Regulatory Periods is described below. The scheme will have three main streams.

a) Price-linked incentive scheme

The performance of Regulated Distribution Systems will be assessed against a number of network performance and service performance measures.²⁴ If performance levels exceed predetermined targets, Regulated Entities will be financially rewarded or, if performance levels fail to meet predetermined performance targets, Regulated Entities will be financially penalized.

The reward or penalty will take the form of a performance incentive factor (S-factor) to be used in price control formula described in Section 4.2.1. The performance incentive factor will be a weighted performance measure, based on the performance levels achieved against a number of indices over the calendar year preceding each Regulatory Year.

b) Guaranteed Service Levels

A system of Guaranteed Service Levels (GSLs) will be introduced for each Regulated Distribution System, in terms of which customers will receive certain guarantees with regard to the responsiveness and effectiveness of Regulated Entities. If these GSLs are not met, predetermined penalties will be paid by the Regulated Entities directly to customers.

c) Information disclosure

The performance of Regulated Distribution Systems against a further number of performance indices (network and service related) will be regularly measured and published.

B2. PRICE-LINKED INCENTIVE SCHEME

B2.1 Capturing the performance rewards or penalties

The performance incentive factor included in the price control formula described in Section 4.2.1, as repeated below, includes an incentive factor (S-factor) that is calculated based on the performance of a Regulated Distribution System against a number of performance indices.

$$MAP_t = [MAP_{t-1} \times \{1 + CWI_t - X\}] + S_t - K_t + ITA_t$$

²⁴ Network performance measures refer to those indices measured directly in terms of Distribution System performance, usually expressed as technical factors. Service performance measures refer to those indices relating directly to the performance of the staff supporting the operation of the Distribution System, usually expressed in terms of the time taken to complete actions, or the number of times actions exceeded or missed target levels.

This factor can be zero, positive or negative, depending on whether actual performance against the (weighted) majority of the indices has exceeded the performance targets discussed below or has fallen below these.

B2.1.1 Service performance indices to be measured

The following service performance indices will be taken into account in calculating the performance incentive factor:

Network Performance Measures

- (a) System average interruption frequency index (SAIFI). A measure of the average number of sustained planned and unplanned service interruptions experienced per customer over the measurement period.
- (b) Customer average interruption duration index (CAIDI). A measure of the average duration of planned and unplanned sustained service interruptions over the measurement period.
- (c) Planned system average interruption duration index (SAIDI). A measure of the average duration of sustained planned service interruptions for all customers over the measurement period.
- (d) Voltage regulation. A measure of the probability of Distribution System voltage levels falling outside the boundaries prescribed in the Distribution Code.
- (e) System losses. An indication of total losses on a Regulated Distribution System, including technical and non-technical losses (but excluding administrative losses).

Service performance measures

- (f) Time to process applications for Regulated Distribution Services.
- (g) Time to connect premises to the Regulated Distribution System after compliance with all government and Regulated Entity requirements.
- (h) Percentage of calls answered at the call centre (or equivalent) within a predetermined time.

Regulated Entities already face a downside potential from the system loss cap that is imposed on Regulated Distribution Systems. It is therefore the intention that the system loss performance index will not have a negative measure– it will be zero or positive only.

B2.1.2 Calculation of the performance incentive factor

The performance incentive factor will be based on a weighted sum of performance components, one for each of the indices noted above. It will be calculated as follows:

$$S_t = \frac{[S_{SAIFI,t} + S_{CAIDI,t} + S_{SAIDI,t} + S_{VoltViol,t} + S_{Sysloss,t} + S_{Proc,t} + S_{Con,t} + S_{Call,t}] \times 0.025ARR_t}{FQ_t}$$

where,

ARR_t = the allowed annual revenue for Regulatory Year t calculated in accordance with Section 4.7.7;

FQ_t = the total amount of energy (expressed in kWh) that is forecast to be delivered to Distribution Connection Points through the relevant

Regulated Distribution System during Regulatory Year t, with the forecast as approved by the ERC;

and

$$S_{SAIFI,t} = W_{SAIFI} \times Perf_{SAIFI,t-1}$$

where, $S_{SAIFI,t}$ = S-component for SAIFI for Regulatory Year t;
 W_{SAIFI} = Weighting given to the SAIFI S-component; and
 $Perf_{SAIFI,t-1}$ = SAIFI performance assessment for the calendar year ending on December 31 of Regulatory Year t-1.

$$S_{CAIDI,t} = W_{CAIDI} \times Perf_{CAIDI,t-1}$$

where, $S_{CAIDI,t}$ = S-component, CAIDI for Regulatory Year t;
 W_{CAIDI} = Weighting given to the CAIDI S-component; and
 $Perf_{CAIDI,t-1}$ = CAIDI performance assessment for the calendar year ending on December 31 of Regulatory Year t-1.

$$S_{SAIDI,t} = W_{SAIDI} \times Perf_{SAIDI,t-1}$$

where, $S_{SAIDI,t}$ = S-component for planned SAIDI for Regulatory Year t;
 W_{SAIDI} = Weighting given to the SAIDI S-component; and
 $Perf_{SAIDI,t-1}$ = Planned SAIDI performance assessment for the calendar year ending on December 31 of Regulatory Year t-1.

$$S_{VoltViol,t} = W_{VoltViol} \times Perf_{VoltViol,t-1}$$

where, $S_{VoltViol,t}$ = S-component for voltage regulation performance for Regulatory Year t;
 $W_{VoltViol}$ = Weighting given to the voltage regulation S-component; and
 $Perf_{VoltViol,t-1}$ = Voltage regulation performance assessment for the calendar year ending on December 31 of Regulatory Year t-1.

$$S_{Sysloss,t} = W_{Sysloss} \times Perf_{Sysloss,t-1}$$

where, $S_{Sysloss,t}$ = S-component for system losses performance for Regulatory Year t;
 $W_{Sysloss}$ = Weighting given to the system losses S-component; and

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$Perf_{Sysloss,t-1}$ = System losses performance assessment for the calendar year ending on December 31 of Regulatory Year t-1.

$$S_{Proc,t} = W_{Proc} \times Perf_{Proc,t-1}$$

where, $S_{Proc,t}$ = S-component for time to process applications for Regulatory Distribution Services for Regulatory Year t;

W_{Proc} = Weighting given to the process time S-component; and

$Perf_{Proc,t-1}$ = Process time performance assessment for the calendar year ending on December 31 of Regulatory Year t-1.

$$S_{Con,t} = W_{Con} \times Perf_{Con,t-1}$$

where, $S_{Con,t}$ = S-component for time to provide connection to the Regulated Distribution System for Regulatory Year t;

W_{Con} = Weighting given to the service connection time S-component; and

$Perf_{Con,t-1}$ = Connection time performance assessment for the calendar year ending on December 31 of Regulatory Year t-1.

$$S_{Call,t} = W_{Call} \times Perf_{Call,t-1}$$

where, $S_{Call,t}$ = S-component for call-center performance for Regulatory Year t;

W_{Call} = Weighting given to the call-center performance S-component; and

$Perf_{Call,t-1}$ = Call-center performance assessment for the calendar year ending on December 31 of Regulatory Year t-1.

Since the assessment period for RY2012 will fall within the Second Regulatory Period (calendar year ending December 31, 2010), S_{2012} will be based on the Performance Incentive Scheme approved by the ERC for the Second Regulatory Period.

The assessment period for RY2013 will fall halfway within the Second Regulatory Period (calendar year ending December 31, 2011). To avoid a situation where performance bonuses or penalties will be based on performance over a period where the details of the incentive scheme has not yet been approved, S_{2013} will be based on the Performance Incentive Scheme approved by the ERC for the Second Regulatory Period.

B2.1.3 Weighting of the performance indices

In terms of Section 8.2.3 (c) the total level of the rewards or penalties under the performance incentive scheme for any Regulatory Year should not exceed 3 % of the allowed annual revenue for a Regulated Distribution System for that year. As the performance incentive scheme will have two streams involving possible changes to the annual revenue that can be earned, the following ceilings will apply to these streams:

- a) The maximum value of the price-linked incentive scheme in any Regulatory Year will be capped at 2.5% of the annual revenue requirement for that Regulatory Year.
- b) The revenue allowance for the GSL scheme will be set at 0.5 % of the annual revenue requirement in any Regulatory Year as calculated before the GSL scheme is taken into account.

The ceiling on the price-linked incentive scheme is already accounted for in the formulas in Section B2.1.2. The weightings set out in table B1 will be applied to the various performance S-components.

Table B1 : Weightings for the S-components

Component	Symbol	Weighting
SAIFI (planned & unplanned)	W_{SAIFI}	0.20
CAIDI (planned & unplanned)	W_{CAIDI}	0.20
SAIDI (planned)	W_{SAIDI}	0.15
Voltage regulation	$W_{VoltViol}$	0.10
System losses	$W_{SysLoss}$	0.05
Time to process applications	W_{Proc}	0.10
Time to connect premises	W_{Con}	0.10
Call-center performance	W_{Call}	0.10

B2.1.4 Determination of the performance targets for the various performance indices

The methodology to determine the performance targets is described below. Regulated Entities are required to collect information about the performance levels of each Regulated Distribution System against these indices over the Third Regulatory Period. This data will be used when determining the final performance bands for the incentive scheme to be implemented during the third regulatory period.

Five discrete performance bands will be used for each performance index, as illustrated in table B2 below. Performance in each of these bands would result in the allocation of a simple performance assessment value to the index being assessed. These are the “Perf”-values described in Section B2.1.2.

Table B2 : Proposed performance assessment bands

Performance band	Description	Performance value
1	Performance greatly below target	-1.0
2	Target not achieved	-0.5

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3	Performance as per expectation	0
4	Target exceeded	0.5
5	Target greatly exceeded	1.0

The expected performance target for each performance index will be set by the ERC as part of its final determination on the price control arrangements for the Third Regulatory Period. For each performance index, the target may be set at:

- a) the historical performance level of a Regulated Entity against that index, based on the average annual performance against this index for the five-year period ending on June 30, 2010; or
- b) an improvement over the historical performance level of a Regulated Entity against that index, as determined by the ERC based on benchmarking against the performance of the other Philippines privately-owned electricity distribution utilities and/or similar international utilities. Such benchmarking will allow for the normalization of physical, economic and regulatory differences between distribution utilities, and the results will be subject to public consultation prior to setting performance targets.

The manner in which the bands will be set for each performance index is described in table B3 (a-g) below.

Table B3a : Setting of performance bands for SAIFI performance

SAIFI	
SAIFI target	SAIFI performance target set by the ERC for the Third Regulatory Period
Standard deviation	Standard deviation of the annual SAIFI values for a Regulated Distribution System for the 8 years ending on June 30, 2010
Performance greatly below target	Annual SAIFI more than 2 standard deviations above the SAIFI target
Target not achieved	Annual SAIFI more than 1 standard deviation, but less than or equal to 2 standard deviations, above the SAIFI target
Performance as per expectation	Annual SAIFI between or equal to 1 standard deviation above and 1 standard deviation below the SAIFI target
Target exceeded	Annual SAIFI more than 1 standard deviation, but less than or equal to 2 standard deviations, below the SAIFI target
Target greatly exceeded	Annual SAIFI more than 2 standard deviations below the SAIFI target

Table B3b : Setting of performance bands for CAIDI performance

CAIDI	
CAIDI target	CAIDI performance target set by the ERC for the Third Regulatory Period
Standard deviation	Standard deviation of the annual CAIDI values for a Regulated Distribution System for the 8 years ending on June 30, 2010
Performance greatly below target	Annual CAIDI more than 2 standard deviations above the CAIDI target
Target not achieved	Annual CAIDI more than 1 standard deviation, but less than or equal to 2 standard deviations, above the CAIDI target
Performance as per expectation	Annual CAIDI between or equal to 1 standard deviation above and 1 standard deviation below the CAIDI target value
Target exceeded	Annual CAIDI more than 1 standard deviation, but less than or equal to 2 standard deviations, below the CAIDI target
Target greatly exceeded	Annual CAIDI more than 2 standard deviations below the CAIDI target

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Table B3c : Setting of performance bands for planned SAIDI performance

SAIDI	
Planned SAIDI target	Planned SAIDI performance target set by the ERC for the Third Regulatory Period
Standard deviation	Standard deviation of the annual planned SAIDI values for a Regulated Distribution System for the 8 years ending on June 30, 2010
Performance greatly below target	Annual planned SAIDI more than 2 standard deviations above the planned SAIDI target
Target not achieved	Annual planned SAIDI more than 1 standard deviation, but less than or equal to 2 standard deviations, above the planned SAIDI target
Performance as per expectation	Annual planned SAIDI between or equal to 1 standard deviation above and 1 standard deviation below the planned SAIDI target value
Target exceeded	Annual planned SAIDI more than 1 standard deviation, but less than or equal to 2 standard deviations, below the planned SAIDI target
Target greatly exceeded	Annual planned SAIDI more than 2 standard deviations below the planned SAIDI target

Table B3d : Setting of performance bands for voltage regulation performance

VOLTAGE REGULATION	
Target probability of voltage violation (pV_v)	Voltage regulation performance target set by the ERC for the Third Regulatory Period
Standard deviation	Standard deviation of the annual voltage regulation values for a Regulated Distribution System for the 5 years ending on June 30, 2010
Performance greatly below target	Annual voltage regulation more than 2 standard deviations above the voltage regulation target
Target not achieved	Annual voltage regulation more than 1 standard deviation, but less than or equal to 2 standard deviations, above the voltage regulation target
Performance as per expectation	Annual voltage regulation between or equal to 1 standard deviation above and 1 standard deviation below the voltage regulation target value
Target exceeded	Annual voltage regulation more than 1 standard deviation, but less than or equal to 2 standard deviations, below the voltage regulation target
Target greatly exceeded	Annual voltage regulation more than 2 standard deviations below the voltage regulation target

Table B3e : Setting of performance bands for system losses

SYSTEM LOSSES	
Target for system losses	8.5%
Performance greatly below target	Not applicable
Target not achieved	Not applicable
Performance as per expectation	System losses on or between 7.5% to 8.5%
Target exceeded	System losses between 6.5% and 7.5%
Target greatly exceeded	System losses less than or equal to 6.5%

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Table B3f : Setting of performance bands for time to process applications

TIME TO PROCESS SERVICE APPLICATIONS	
Target time to process a service application	Target application processing time set by the ERC for the Third Regulatory Period
Standard deviation	Standard deviation of the target time to process applications, for the 5 years ending on June 30, 2010
Performance greatly below target	Annual target processing time more than 2 standard deviations above the service application target value
Target not achieved	Annual target processing time more than 1 standard deviation, but less than or equal to 2 standard deviations, above the service application target value
Performance as per expectation	Annual target processing time between or equal to 1 standard deviation above and 1 standard deviation below the service application target value
Target exceeded	Annual target processing time more than 1 standard deviation, but less than or equal to 2 standard deviations, below the service application target value
Target greatly exceeded	Annual target processing time more than 2 standard deviations below the service application target value

Table B3g : Setting of performance bands for time to provide connection

TIME TO PROVIDE CONNECTIONS	
Target time to provide a connection	Target time to provide a connection set by the ERC for the Third Regulatory Period
Standard deviation	Standard deviation of the target time to provide a connection, for the 5 years ending on June 30, 2010
Performance greatly below target	Annual target connection time more than 2 standard deviations above the connection target value
Target not achieved	Annual target connection time more than 1 standard deviation, but less than or equal to 2 standard deviations, above the connection target value
Performance as per expectation	Annual target connection time between or equal to 1 standard deviation above and 1 standard deviation below the connection target value
Target exceeded	Annual target connection time more than 1 standard deviation, but less than or equal to 2 standard deviations, below the connection target value
Target greatly exceeded	Annual target connection time more than 2 standard deviations below the connection target value

Table B3h : Setting of performance bands for call center performance

CALL CENTER PERFORMANCE	
Call-centre performance target	Target percentage of calls answered within 30 seconds, set by the ERC for Third Regulatory Period. (This could also be the average time taken to answer calls.)
Standard deviation	Standard deviation of the target call-centre performance target, for the 5 years ending on June 30, 2010
Performance greatly below target	Annual target connection time more than 2 standard deviations above the call-centre performance target value
Target not achieved	Annual target connection time more than 1 standard deviation, but less than or equal to 2 standard deviations, above the call-centre performance target value
Performance as per expectation	Annual target connection time between or equal to 1 standard deviation above and 1 standard deviation below the call-centre performance target value
Target exceeded	Annual target connection time more than 1 standard deviation, but less than or equal to 2 standard deviations, below the call-centre performance target value
Target greatly exceeded	Annual target connection time more than 2 standard deviations below the call-centre performance target value

B3 GUARANTEED SERVICE LEVELS SCHEME

A guaranteed service levels (GSL) scheme will be applied to Regulated Distribution Systems in terms of which Regulated Entities will compensate a Customer directly if certain service delivery performance thresholds are not met.

B3.1 Proposed GSL indices and payment levels

The indices that will be included in the GSL scheme are listed below. The actual performance targets for each index will be determined by the ERC during the reset process for the Third Regulatory Period.

- a) GSL1 : a Customer of a Regulated Distribution System experiencing more than the target time of sustained interruptions over any Regulatory Year;
- b) GSL2 : a Customer of a Regulated Distribution System experiencing more than the target number of sustained interruptions in a Regulatory Year;
- c) GSL3 : restoration of service to a Customer after a fault on the secondary side of a Regulated Distribution System, including the service drop, does not occur within the target time after the fault occurring; and
- d) GSL4 : the Regulated Entity failing to provide a connection to a Customer on the day promised, with cumulative payments applying for each day that a connection is later than promised, up to a maximum of five days.

Regulated Entities should collect performance data against each of these indices during the course of the Third Regulatory Period. This data will be provided to the ERC during the reset period for the Third Regulatory Period, not later than twelve months before the start of the Third Regulatory Period, or as requested by the ERC. Final targets will be based on this information, as approved by the ERC.

B3.2 Determining the penalty levels

Setting appropriate GSL performance levels requires current information on actual performance against the indices. The ERC will collect the information from Regulated Entities over the Third Regulatory Period to determine the penalty levels that will apply when GSLs are not met.

The methodology that will be used to establish the penalty levels is as follows:

- (a) The ERC will calculate the total revenue allocation for the GSL scheme. In accordance with Section B2.1.3(b) , this allocation will be calculated as 0.5 % of the annual revenue requirement. Penalty levels will be constant for the whole of the Third Regulatory Period, these will be based on the annual revenue requirement for Regulatory Year 2011 (the start of the period).

$$GSLRev = 0.005 \times ARR_{2011}$$

where ARR_{2011} is the annual revenue requirement for Regulatory Year 2011 calculated in accordance with Section 4.7.7 (carried forward to article VI for subsequent regulatory periods)

- (b) Based on the data submitted by the Regulated Entities and the performance targets established for each index, the ERC will assess the likely number of instances in a year that each of the performance target levels will be exceeded. For example, the number

of customers likely to have faults exceeding the target time duration (GSL3) during Regulatory Year t would be $nGSL3$.

- (c) By allocating the same weighting to all the proposed GSL indices, the revenue allocation will be made per index. For example, the revenue allocated to the GSL3 measure would be :

$$GSL3Rev = 0.25 \times GSLRev$$

- (d) The penalty amount for each index will be calculated by dividing the revenue allocation for each index by the estimated number of times that the penalty level for that index is expected to be exceeded. For example, the penalty payable each time that an interruption on the secondary side of a Regulated Distribution System is not restored within the target time, would result in a penalty amount (rounded off) of :

$$PenGSL3 = \frac{GSL3Rev}{nGSL3}$$

B3.3 Adapting revenue requirements

An additional allowance will be made over and above the annual revenue requirement for each Regulated Entity, to cover the anticipated average amount that would be payable towards the GSL scheme. While this allowance will not be part of the annual revenue requirement (which is calculated based on the building blocks), it will be added to the annual revenue requirement for each Regulatory Year during the Third Regulatory Period for the purposes of calculating the smoothing factor and setting the initial price cap that will apply for the Third Regulatory Period.

Regulated Entities who manage to perform better than forecasted against the GSL will be allowed to retain the savings on the extra revenue allowance. Conversely, those Regulated Entities that pay out more penalties than forecast, will bear the additional cost, up to a maximum of 0.5% of the annual revenue requirement for a Regulatory Year.²⁵

This intention of the 0.5% of the annual revenue requirement allowance is to allow Regulated Entities the option of incurring additional expenditure to avoid penalty situations, or to remain revenue neutral if they maintain current performance levels.

B4 Excluded events

There are a number of external events which can have a substantial impact on the actual performance of Regulated Distribution Systems against performance indices, but that are predominantly outside the control of Regulated Entities. The ERC will allow these events to be excluded from the statistics used to calculate network or service performance.

Events of which the impact on the performance of a Regulated Distribution System will generally be excluded are:

- supply interruptions made at the request of a customer;
- load shedding due to a shortfall in generation;
- supply interruptions caused by a failure of the transmission network;

²⁵ If this value is exceeded, the cap of 3% of the annual revenue requirement for the performance incentive scheme could be breached.

- excessive distribution voltage regulation caused by voltage levels at the transmission supply points falling outside the boundaries described in the Philippine Grid Code;²⁶
- supply interruptions caused by a failure of a transmission connection asset, but only to the extent that the interruptions were not due to inadequate planning of transmission connections; and
- widespread supply interruptions due to rare and extreme events which were not reasonably able to be foreseen, or if they could be foreseen, for which the impact could still not be effectively mitigated even if appropriate responses were provided.

A Regulated Entity wishing to exclude the impact of a certain event from the calculation of the service performance incentive scheme would need to provide the ERC with the following:

- a detailed description of the nature of the event for which an exclusion is sought and the reasons justifying the exclusion of the event, including the provision of supporting evidence;
- evidence of the impact of the event on the Regulated Distribution System reliability performance, for each of the measures adversely affected;
- a description of the steps that the Regulated Entity took to mitigate against or respond to the events; and
- evidence that the Regulated Entity was unable to further mitigate against the impact of the event.

The ERC will adopt the Beta Method, developed by the Institute for Electrical and Electronic Engineers (IEEE) to identify major event days.²⁷

Further tests will be applied to determine the main cause(s) for the major event days, isolating, where appropriate, the underlying event and formally classing it as “severe”. These tests include assessing the nature and rarity of an event, the ability to foresee and prepare for an event, the ability of distribution companies to mitigate the effects of an event, and the reaction of Regulated Entities after the event.

If after this consideration the ERC approves the classification of an event as extreme, the impact of the event on the performance indices would be excluded from the performance statistics used as part of the performance incentive scheme.

B5 Information disclosure

The third component of the performance incentive scheme is the measurement and disclosure of further performance data. From the third regulatory period, Regulated Entities will be required to measure the performance of each Regulated Distribution System against the following indices:

²⁶ Section 3.2.3.4 of the Philippine Grid Code (R.A. 9136) prescribes the RMS value of the long-duration voltage to be ensured at any (transmission) Connection Point by the Grid Owner and System Operator to be greater than 95% but less than 105% of the nominal (transmission) voltage level.

²⁷ IEEE Power Engineering Society. (2004, May). IEEE Std 1366TM – 2003. IEEE Guide for Electric Power Distribution Reliability Indices. New York, USA. Institute of Electronics and Electrical Engineers (IEEE)

Network performance indices

- momentary average interruption frequency index (MAIFI);
- frequency of tripping events per 100 circuit-km;

Service performance indices

- average time to respond to queries and complaints;
- average time to reconnect a service after payment of all dues and customer's compliance with the Regulated Entity's and Local Government Unit's requirements.

The information, broken down monthly, has to be collected and supplied to the ERC annually. In addition to the monthly figures, the cumulative performance total against each index must also be provided, from the start of the corresponding calendar year till the end of the month for which each index was measured.

The ERC intends to annually publicize the information disclosure data for all Regulated Distribution Systems.

APPENDIX C

CRITERIA FOR REGULATORY RESET EXPERTS

The main categories for which Regulatory Reset Experts will be retained by the ERC are listed below, with the experience and qualifications required for individual experts working on each category. These experience levels and qualifications may not necessary all lie in a single expert, but rather in a team, or in a group of one or more experts working on a category. Any individual making up part of such a team or group of Regulatory Reset Experts working on a category, should have qualifications in one or more of the areas listed, and have experience in one or more of the aspects listed against that particular category.

The requirements noted below are not intended to prevent a Regulatory Reset Expert from using the support of analysts, administrative or other supporting staff in the provision of services to the ERC in terms of the DWRG and it is not required or expected that such supporting staff should have the experience or qualifications noted below. However, a Regulatory Reset Expert shall review all the outputs from such supporting staff and accept full professional responsibility for such outputs. All information and reports provided by a Regulatory Reset Expert to the ERC shall be presented by the Regulatory Reset Expert in his/her own name and capacity.

Asset valuation

Have experience in:

- Appraising electricity network plant and equipment, and land and buildings, within the Philippines using a fair value methodology;
- Valuing electricity distribution network assets, in an overseas jurisdiction, using an optimized replacement cost valuation methodology; and
- Assisting regulated entities and/or regulators in overseas jurisdictions in reviewing or determining regulatory asset bases used for the purposes of incentive or performance based regulatory arrangements.

Have qualifications in (see below):

- Engineering;
- Accounting; and
- Business or Commerce.

Distribution system design, construction, maintenance and operation, load flow modeling and distribution network benchmark service performance

Have experience in:

- Electricity network load flow modeling;
- Design, construction and maintenance of electricity distribution networks, including project cost estimation, project planning, cost control and network constraint elimination;
- Measuring and monitoring electricity network performance;
- Design and/or augmentation of electricity networks for reduced line losses; and

- Electricity network performance monitoring and benchmarking against overseas distribution entities.

Have:

- Qualifications in Engineering (see below); or
- Other qualifications relevant to the matters referred to above.

Accounting

Have experience in:

- Administering, reviewing or developing financial accounting, asset register or operational systems;
- Auditing, accounting, asset register and operational systems, leading to the issuance of an audit opinion on statutory financial reports; and
- Assisting with asset valuation assignments.

Have qualifications in:

- Accounting (see below).

Corporate finance, financial modeling and pricing

Have experience in:

- Principles of asset valuation of electricity networks to optimized replacement cost and/or deprival value;
- Estimation of weighted average cost of capital for regulatory and commercial purposes;
- Cash flow and financial modeling and financial forecasting;
- Credit rating analysis and estimation;
- Analysis and/or development of operating and maintenance expenditure, and capital expenditure, forecasts in the electricity sector;
- Developing submissions to electricity regulators or as a regulator/regulator's advisor in examining such submissions;
- Regulation of electricity network prices or tariffs;
- Analysis of service and financial performance against local and overseas benchmarks; and
- Analysis of discounted cash flow or similar financial modeling.

Have qualifications in (see below):

- Business or Commerce;
- Economics;
- Accounting; and
- Engineering.

Economic analysis and economic modeling

Have experience in:

- Economic forecasting of economic growth and/or electricity demand.

Have qualifications in:

- Economics (see below).

Fire Inspection

Have experience in:

- Investigation of the causes of fires in buildings or plant and equipment; and
- Assessing the risks of fire and effectiveness of fire prevention and control systems.

Have qualifications in:

- Engineering (see below); or
- Fire investigation.

Insurance and claims risk adjustment

Have experience in:

- Investigation and assessment of force majeure events; and
- Estimation or examination of the costs resulting from force majeure events, including direct replacement costs and the opportunity costs associated with continuation of electricity supply.

Have qualifications in (see below):

- Engineering; or
- Business or Commerce; or
- as an Actuary.

Professional qualifications

Where a person is required to have qualifications in Accounting, that person must be registered as a certified public accountant under the Revised Accountancy Law (Presidential Decree No.692) who possesses the independence as defined in Part II Section 14 of the Code of Professional Ethics for Certified Public Accountants as promulgated by the Board of Accountancy and approved by the Professional Regulation Commission.

Where a person is required to have qualifications in Engineering, Economics or Business or Commerce, or as an Actuary, that person must:

- have graduate or post graduate qualifications in that discipline from a reputable Philippines or overseas university, with demonstrable experience of having worked in that field for three years or longer; or
- be a member of a professional institute in the Philippines or an overseas jurisdiction which represents that discipline, with a grading according to the rules of that institute that is higher than entry or training level.

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Notwithstanding the above, the ERC may decide to appoint a Regulatory Reset Expert who does not comply with these requirements for professional qualifications, where it has been proven to the satisfaction of the ERC that the Reset Expert has more than 10 years demonstrable professional experience in the relevant discipline that is directly relevant to the service to be rendered. In such a case the ERC will communicate the decision in advance to the affected Regulated Entity or Entities, providing the supporting information on the experience of the intended Regulatory Reset Expert and why this appointment is considered appropriate for the task to be performed.

APPENDIX D
FUTURE ENTRY POINTS

Following ERC Resolution No. 16 Series of 2006, all privately owned electricity distribution utilities in the Philippines that did not enter Performance Based Regulation at the first Entry Point, with entry date July 1, 2007, are obliged to enter Performance Based Regulation over the period October 1, 2008 to July 1, 2011.

To allow these future entries to occur in an ordered manner, entrants have been divided into four Entrant Groups, as described in table E1 below. The dates for the reset process, as well as the Third Regulatory Period associated with each Entrant Group are also indicated.²⁸

Table E1 : Entrant Groups for Performance Based Regulation

<p><u>First entry group</u> Cagayan Electric Light & Power Company Dagupan Electric Corporation Manila Electric Company</p>	<p><u>Reset period</u> Jan 1, 2010 to Jun 30, 2011</p> <p><u>Second Regulatory Period</u> Jul 1, 2007 to Jun 30, 2011</p> <p><u>Third Regulatory Period</u> Jul 1, 2011 to June 30, 2015</p>
<p><u>Second Entry Group</u> Cotabato Light & Power Company, Inc Iligan Light & Power Company, Inc Mactan Electric Company</p>	<p><u>Reset period</u> Apr 1, 2011 to Mar 31, 2013</p> <p><u>Second Regulatory Period</u> Apr 1, 2009 to Mar 31, 2013</p> <p><u>Third Regulatory Period</u> Apr 1, 2013 to Mar 31, 2017</p>
<p><u>Third entry group</u> Cabanatuan Electric Corporation Davao Light & Power Company, Inc Ibaan Electric and Engineering Corp La Union Electric Company, Inc Tarlac Electric Inc Visayan Electric Company, Inc</p>	<p><u>Reset period</u> Jan 1, 2009 to Jun 30, 2010*</p> <p><u>Second Regulatory Period</u> Jul 1, 2010 to Jun 30, 2014</p> <p><u>Third Regulatory Period</u> Jul 1, 2014 to Jun 30, 2018</p>
<p><u>Fourth entry group</u> Angeles Electric Corporation Bohol Light Company Inc Clark Electric Distribution Company</p>	<p><u>Reset period</u> Sep 1, 2009 to Mar 31, 2011*</p> <p><u>Second Regulatory Period</u> Apr 1, 2011 to Mar 31, 2015</p> <p><u>Third Regulatory Period</u></p>

²⁸ None of the later Entrant Groups were subject to a First Regulatory Period as described in the original Distribution Wheeling Rate Guidelines and all therefore commence Performance Based Regulation in the Third Regulatory Period.

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Panay Electric Company Subic Enerzone Corporation San Fernando Electric Light & Power Company	Apr 1, 2015 to Mar 31, 2019
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* For the 3rd and 4th entry groups the reset period refers to that for the Second Regulatory Period.

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**APPENDIX F
CONTRIBUTION TO REGULATORY RESET COSTS**

In terms of Section 14.4, all Regulated Entities will contribute proportionally to the costs of Regulatory Reset Experts retained by the ERC. These costs will be split according to energy sales incurred by each Regulated Entity during the Measurement Period which, for the Third Regulatory Period, is the average of the three calendar years 2006 to 2008. The energy sales for the Measurement Period and the resulting proportional cost split are indicated below.

Regulated Entities	Acronyms	MWh Sold				Split
		2006	2007	2008	Avg	
Manila Electric Corp	MERALCO	25,077,531	26,218,707	26,799,238	26,031,825	80.23%
Cagayan de Oro Electric Power & Light Company	CEPALCO	613,124	659,095	649,883	640,701	1.97%
Dagupan Electric Corp	DECORP	213,835	221,343	212,685	215,955	0.67%
Mactan Electric Company	MECO	215,261	238,009	244,096	232,455	0.72%
Cotabato Light and Power Company, Inc.	CLPC	112,928	117,523	118,450	116,300	0.36%
Iligan Light and Power, Inc.	ILPI	172,436	176,792	168,267	172,498	0.53%
Cabanatuan Electric Corporation	CELCOR	135,284	140,032	145,871	140,396	0.43%
Davao Light & Power Company, Inc.	DLPC	1,268,944	1,331,437	1,370,951	1,323,778	4.08%
Ibaan Electric and Engineering Corporation	IEEC	13,970	14,804	15,127	14,634	0.05%
La Union Electric Co., Inc.	LUECO	106,301	110,937	113,168	110,135	0.34%
Tarlac Electric, Incorporated	TEI	196,102	202,971	205,771	201,615	0.62%
Visayan Electric Company, Inc.	VECO	1,571,381	1,680,537	1,766,059	1,672,659	5.16%
Angeles Electric Company, Inc.	AEC	320,591	329,733	339,249	329,858	1.02%
Bohol Light Company, Inc.	BLCI	68,107	72,879	77,885	72,957	0.22%
Clark Electric Distribution Company	CEDC	186,243	228,836	250,035	221,705	0.68%
San Fernando Electric Light & Power Co., Inc.	SFELAPCO	365,639	391,999	406,022	387,887	1.20%
Subic Enerzone Corporation	SEZC	179,006	199,083	298,050	225,380	0.69%
Panay Electric Company, Inc.	PECO	320,591	329,733	339,249	329,858	1.04%
	TOTAL	31,149,352	32,675,529	33,515,620	32,446,834	