

CIRCULAR FOR BROKERS NO. 4672 -2004

Disclosure

October 22, 2004

DATE

## SECURITIES AND EXCHANGE COMMISSION

### SEC FORM 17-C

### CURRENT REPORT UNDER SECTION 17 OF THE SECURITIES REGULATION CODE AND SRC RULE 17.2(c) THEREUNDER

1. **Date of Report:** *October 22, 2004*
2. **SEC Identification Number:** *PW-102*
3. **BIR Tax Identification Code:** *350-000-101-528*
4. **Name of Issuer as specified in its Charter:** *Manila Electric Company*
5. **Country of Incorporation:** *Philippines*
6. **Industry Classification:** *(SEC use only)*
7. **Address of principal office:** *Lopez Building, Ortigas Avenue, Pasig City*
8. **Issuer's telephone numbers:** *16220 local 3186 Area Code: 0300*
9. **Former name or former address:** *Not Applicable*
10. **Securities registered pursuant to Sections 18 and 12 of the SRC or Sections 4 and 8 of the RSA:**

<u>Title of Each Class</u>	<u>Number of Shares of Common Stock Outstanding</u>
Class "A"	604,438,658
Class "B"	<u>402,988,744</u>
Total	<u>1,007,427,402</u>

**Amount of Debt Outstanding:** *P98.5 Billion (as of August 31, 2004)*

**11. Item Number reported:****Item 5 (Legal Proceedings)**

**1. The Energy Regulatory Commission (ERC), in its Order dated September 20, 2004 and released on October 15, 2004, approved the recovery from Meralco customers, through the generation charge, the amount of ₱366.8 million or ₱0.0080 per kWh for 24 months, representing a portion of the transmission line cost billed by Quezon Power Phil. Ltd. (QPPL) to Meralco from June 2000 to March 2004. This is on top of the ₱0.0127 per kWh initially approved by the ERC for a portion of the transmission line cost QPPL billed to Meralco from June 2000 to September 2002. The ₱0.0127 was billed to customers beginning June 2003 and will continue until May 2006, while the ₱0.0080 will be billed from November 2004 to October 2006.**

**Of the US\$88.8 million total transmission line cost, the ERC disallowed the recovery from customers of US\$28.06 million or 31.6% due to project delays "caused by management inefficiency on the part of NPC" [National Power Corporation]. These include "NPC's giving priority to its Independent Power Producer (IPP), the Sual Plant," as a result of which "QPPL had to adjust its commissioning activities in order to conduct as much testing as possible within the restrictions imposed by NPC."**

**QPPL is an Independent Power Producer, which advanced the cost of building transmission lines from its plant to the nearest National Transmission Corporation's (TransCo) facility in order to supply power to Meralco for its customers. The transmission line (T/line) cost billed by QPPL forms part of the generation charge and is revenue-neutral to Meralco (ERC Case Nos. 2001-646 and 2001-900; ERC Case No 2001-383; and ERC Case No. 2004-20).**

**2. The Energy Regulatory Commission (ERC) released its Order dated October 14, 2004 on the scheme for phasing out the inter-class cross-subsidy of Meralco. This will be a 2-year phase out, starting with 40% removal effective October 2004 billing cycle parallel with the intra-grid cross-subsidy removal scheme of the National Transmission Corporation (TransCo). The initial 40% removal will result in a 28.52-centavo per kWh reduction of the subsidy being enjoyed by residential customers, which in turn will reduce the subsidy burden of commercial and industrial customers ranging from 3.57 centavos to 31.29 centavos per kWh. The ERC also ordered, however, that the High Load Factor discount currently enjoyed by industries with a minimum demand of 5 MW will no longer be allowed for recovery through the Generation Charge, upon implementation of the cross-subsidy removal scheme (ERC Case Nos. 2001-646 and 2001-900).**

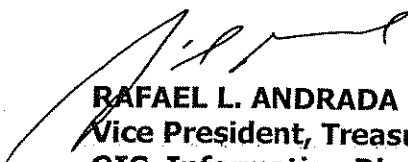
**Item 9 (Other Events)**

*The ERC released attached Order dated October 13, 2004 adopting the Guidelines for the Automatic Adjustment of Generation Rates and System Loss Rates by Distribution Utilities (ERC Case No. 2004-322).*

**SIGNATURE**

Pursuant to the requirements of the Securities Regulation Code, the issuer has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

**MANILA ELECTRIC COMPANY**  
Issuer

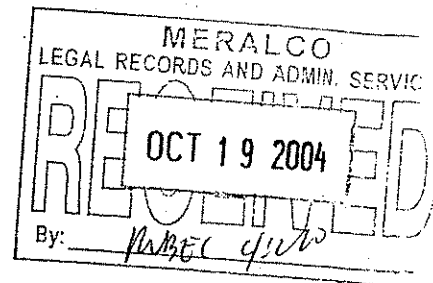


**RAFAEL L. ANDRADA**  
Vice President, Treasurer &  
OIC, Information Disclosure Officer

Date: October 22, 2004

cc: Disclosure Department  
Listings and Disclosure Group  
Philippine Stock Exchange (PSE)

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



**IN THE MATTER OF THE ADOPTION  
OF THE GUIDELINES FOR THE  
AUTOMATIC ADJUSTMENT OF  
GENERATION RATES AND SYSTEM  
LOSS RATES BY DISTRIBUTION  
UTILITIES**

**ERC Case No. 2004-322**

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**D O C K E T E D**  
Date: OCT 18 2004  
By: [Signature]

**ORDER**

Pursuant to Section 43 (f) of Republic Act No. 9136, otherwise known as the Electric Power Industry Reform Act of 2001 (EPIRA), the Energy Regulatory Commission (the Commission for brevity) is authorized to adopt alternative forms of internationally-accepted rate setting methodology that will ensure reasonable price of electricity and non-discriminatory rates.

At present, Distribution Utilities (DUs) recover their generation costs through the Generation Rate Adjustment Mechanism (GRAM), which is a deferred recovery mechanism using a three (3) month test period. The GRAM provides a Deferred Accounting Adjustment (DAA) consisting of any under/over recoveries plus the corresponding carrying charge and recoverable over the same test period.

The implementation of the GRAM had been criticized for, among others, the following reasons: a) it does not represent the true cost of power during the period for which it is being recovered; and b) it resulted to cash flow problems on the part of the DUs.

Relative thereto, the Commission formulated a new methodology for the DUs to recover any adjustments in the generation rates and system loss rates to be known as the "Guidelines for the Automatic Adjustment of Generation Rates and System Loss Rates by Distribution Utilities".

Relative thereto, the Commission issued a Notice on September 15, 2004 setting the Guidelines for public consultation on October 4, 2004. Said Notice as well as the Guidelines were posted in the Commission's website as early as September 14, 2004 and published in the *Manila Standard* on September 18, 2004.

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[Handwritten signature]

In the aforesaid Notice, interested parties were directed to submit their written comments on the said proposed Guidelines on or before September 30, 2004.

In compliance therewith, the following parties filed their respective written comments on various dates:

1. Visayan Electric Company, Inc. (VECO);
2. Cotabato Light and Power Company (COLIGHT);
3. Dagupan Electric Corporation (DECORP);
4. Zamboanga City Electric Cooperative, Inc. (ZAMCELCO);
5. Iligan Light and Power, Inc. (ILPI);
6. Cagayan Electric Power and Light Company, Inc. (CEPALCO);
7. Benguet Electric Cooperative, Inc. (BENELCO);
8. Manila Electric Company (MERALCO);
9. Misamis Oriental II Electric Service Cooperative, Inc. (MORESCO);
10. Cabanatuan Electric Corporation (CELCOR);
11. Consumer Oil & Price Watch (COPW); and
12. Napocor Industrial Consumers Association, Inc. (NICAI).

At the scheduled public consultation on October 4, 2004, representatives of the various distribution utilities appeared and were given opportunities to elaborate their submitted written comments. They were, likewise, allowed to manifest their additional comments.

On the other hand, the consumer sector was represented by a representative of the National Association of Electricity Consumers for Reforms, Inc. (NASECORE) who requested that a separate consultation be conducted exclusively for the residential consumers to enable them to fully understand the nature and effects of the proposed guidelines.

### **ISSUES**

The following issues were raised: a) deduction of the Prompt Payment Discount (PPD) from recoverable generation costs; b) inclusion of a correction factor in the formula to address errors in power bills from suppliers; c) calculation of the system loss charge; d) calculation of the Average Transmission Rates (ATR); e) effect of the proposed guidelines on the lifeline rates; and f) transition from the Generation Rate Adjustment Mechanism (GRAM) to the proposed automatic adjustment mechanism.

## DISCUSSION

The DUs were of the opinion that the PPD should not be deducted from the recoverable generation costs considering that fifty percent (50%) of these were already used to reduce their rates in the distribution charges portion of their unbundled rates. They further claimed that under the proposed Guidelines, the consumers would practically be getting another one and a half (1½) discount while giving DUs no more incentive to pay their bills early.

The Commission maintains its position that 50% of the PPD, net of the discounts granted to end-consumers, should be deducted from the generation costs. However, it takes note of the fact that there could be some adjustments in the distribution charges as a result thereof inasmuch as PPD is actually generation-related rather than distribution related.

DUs contended that a correction factor should be incorporated in the formula for computing generation costs to account for errors in power bills from suppliers as well as for possible adjustments for under/over recovery. The Commission finds said contention meritorious. Accordingly, an adjustment factor to be called the "Other Generation Rate Adjustments (OGA)" is adopted and incorporated in the aforementioned formula to address these concerns as well as other adjustments aside from those occurring in the basic generation costs. Incidentally, the Guidelines provides the review and implementation of the OGA.

As to the computation of the system loss charges, DUs alleged that system loss charges may differ from one DU to another. Some DUs have the same system loss charge for all customer classes while others have different system loss charge for each customer class. As such, they asserted that whenever applicable, the calculation of the system loss charge should be on a per customer class basis. This concern is already addressed in the last paragraph of Article IV, Section 1 of the Guidelines wherein it is provided that "actual systems loss can be calculated on an individual customer class level if the DU has the requisite information to support individual Systems Loss Rates".

Another concern raised by the DUs was the calculation of the Average Transmission Rate (ATR). DUs suggested that the calculation of the ATR should be clearly presented. Further, the DUs moved that the transmission costs be based on the recent National Transmission Corporation (TRANSCO) billings rather than their respective unbundling decisions.

The Commission maintains its position that the ATR should be based on the average charge for transmission per unbundling decision. It should be noted that the transmission charge established in the DUs' respective unbundling decisions were so designed to address the incorporation of the three (3) year gradual removal of cross - subsidy in the unbundled rates. As such, the use of the transmission costs based on recent TRANSCO billings for purposes of

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the transmission costs based on recent TRANSCO billings for purposes of computing the ATR would be inappropriate. Accordingly, the ATR should be computed as the Transmission Costs per the DUs' respective unbundling decisions divided by the annualized kWh sales in accordance with the same unbundling decisions.

Finally, DUs requested that there should be a transition provision to cover adjustments for the first period of implementation of the new recovery mechanism. Said concern is already addressed in Article VI of the Guidelines which contains the procedure for the last filing under the GRAM methodology to pave the way for the implementation of the new automatic adjustment mechanism under the Guidelines. Moreover, the correction factor "OGA" in the formula for Generation Charge will include the DAA recoveries/refund pertaining to the GRAM periods.

**WHEREFORE**, the foregoing premises considered, the Commission hereby **RESOLVES TO ADOPT** as it hereby **ADOPTS** the following guidelines:

**GUIDELINES FOR THE AUTOMATIC ADJUSTMENT OF  
GENERATION RATES AND SYSTEM LOSS RATES BY  
DISTRIBUTION UTILITIES**

Pursuant to Section 43 (f) of Republic Act No. 9136 or the Act, Rule 7 of its Implementing Rules and Regulations (IRR) and Section 10 of Republic Act No. 7832, the Energy Regulatory Commission (ERC) hereby adopts and promulgates these Guidelines to establish a process for the automatic adjustment of Generation Rates and System Loss Rates by Distribution Utilities.

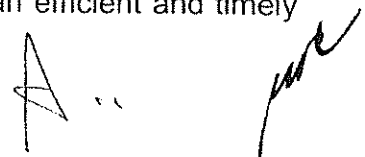
**ARTICLE I**

**GENERAL PROVISIONS**

These Guidelines shall have the following objectives:

- a) To ensure and maintain the quality, reliability, security and affordability of the supply of electric power;
- b) To ensure transparent and reasonable prices of electric power service in a regime of free and fair competition and to achieve greater operational and economic efficiency;
- c) To ensure full recovery of all allowable Generation Costs and other costs associated with the System Loss Caps in an efficient and timely manner; and

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- d) To protect the public interest as it is affected by the rates and services of Distribution Utilities.

## ARTICLE II

### SCOPE AND DEFINITION OF TERMS

**Section 1. Scope** - These Guidelines shall apply to all Distribution Utilities.

**Section 2. Definition of Terms** - As used in these Guidelines, the following terms shall have the following respective meanings:

- a) "**Act**" unless otherwise stated, shall refer to Republic Act No. 9136, otherwise known as the "Electric Power Industry Reform Act of 2001".
- b) "**Average Transmission Rate (ATR)**" shall mean the transmission costs approved per unbundling divided by the annualized kWh sales per unbundling.
- c) "**Deferred Accounting Adjustment (DAA)**" shall mean the component of the generation rate, calculated in accordance with the Generation Rate Adjustment Mechanism (GRAM), intended to recover the deferred accounting balance.
- d) "**Distribution Utility (DU)**" shall refer to any electric cooperative, private corporation, government-owned utility or existing local government unit which has an exclusive franchise to operate a distribution system in accordance with the Act.
- e) "**Energy Regulatory Commission**" or "**ERC**" shall refer to the regulatory agency created by Section 38 of the Act.
- f) "**Generation Cost**" shall mean costs associated with the acquisition of purchased power. Generation costs include only those costs that are reasonable, prudently incurred, and are eligible for recovery in accordance with the current practice of the ERC.
- g) "**Generation Rate**" shall mean the cost of power generated and sold to the distribution utility by the National Power Corporation (NPC) as well as the Independent Power Producers (IPPs), which shall be passed on to the DU's customers, as calculated in the formula prescribed in these Guidelines.



- h) **"Ineligible Supply Contracts"** shall mean power supply agreements entered into by the DUs with the IPPs, which were not approved by the then Energy Regulatory Board or by the ERC.
- i) **"Other Generation Rate Adjustments (OGA)"** shall refer to under(over)-recoveries in generation costs, recoveries from violation of contracts and other pilferages, as well as other adjustments deemed necessary by the ERC, subject to the provisions of these guidelines. The OGA shall not be subject to any carrying charge.
- j) **"Prompt Payment Discount (PPD)"** shall mean the three percent (3%) discount that electric distribution utilities get from NPC for paying their power bills on or before the tenth (10<sup>th</sup>) day of the month following the billing period.
- k) **"System Loss"** shall mean the difference between (kilowatt-hour) kWh purchased and/or generated and kWh sold by a Distribution Utility expressed as a percentage of kWh purchased and/or generated.
- l) **"System Loss Cap"** shall mean the level of System Loss recoverable from customers as established by the ERC in accordance with Section 43 (f) of the Act.
- m) **"System Loss Rate"** shall mean the rate determined in accordance with the formula set forth in Article IV hereof. Individual System Loss Rates may be calculated for different customer classes if the Distribution Utility maintains records on the individual customer class System Loss.

### ARTICLE III

#### MONTHLY ADJUSTMENT OF THE GENERATION RATE

**Section 1. Adjustment Formula** – On the tenth (10) day of each calendar month, Distribution Utilities shall calculate new Generation Rates based on the following formula:

$$GR = AGC + OGA$$

Where:

GR = Generation Rate to be charged per kWh

AGC = Adjusted Generation Cost, automatically computed without need of prior ERC verification and confirmation, as follows:

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$$= \frac{[(GC_i + GC_{ii} + \dots + GC_n) - (PPD * 50\%)]}{TP}$$

GC<sub>i to n</sub> = The Generation Cost in Pesos from source of power 1 through source of power n for the previous month, excluding power sourced from self-generating facilities

PPD = Prompt Payment Discounts availed by the Distribution Utility, net of the Prompt Payment Discounts passed on to the end customers relative to the previous month's generation cost

TP = Total Purchases in kWh for the previous month

OGA = Other Generation Rate Adjustments, refer to adjustments deemed necessary by the Commission after prior verification and confirmation, which shall include, but shall not be limited to, under(over)-recoveries in generation costs and recoveries from violation of contracts and other pilferages. The OGA shall not be subject to any carrying charge.

In the case of ineligible supply contracts, generation costs from such contracts shall not be included in the calculation of recoverable generation costs. In the event, however, that a DU inadvertently or willfully recovers the same, the ERC shall automatically order the refund thereof through the "OGA" without prejudice to the imposition of appropriate penalties.

**Section 2. Billing of New Generation Rate** – The Distribution Utilities shall bill their customers the Generation Rates calculated in accordance with the immediately preceding Section effective on the tenth (10) day of each month.

## ARTICLE IV

### MONTHLY ADJUSTMENT OF THE SYSTEM LOSS RATE

**Section 1. Adjustment Formula** - On the tenth (10) day of each calendar month, Distribution Utilities shall calculate new System Loss Rates based on the following formula:

$$SLR = (GR * U) + (ATR * U)$$

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Where:

SLR = System Loss Rate

GR = Generation Rate calculated in accordance with Article III

ATR = Average Transmission Rate based on the most recent unbundling decision in Peso per kWh, computed as Transmission Costs per unbundling divided by the Annualized Sales in kWh per unbundling

U = Gross Up Factor =  $(\% \text{ System Loss} / [1 - \% \text{ System Loss}])$

The % System Loss is based on the actual System Loss or the System Loss cap whichever is lower plus actual company use or the company use cap of 1% whichever is lower. The actual System Loss and company use are based on the previous month figures to be submitted by the DU. Actual System Loss can be calculated on an individual customer class level if the Distribution Utility has the requisite information to support individual System Loss Rates.

**Section 2. Billing of System Loss Rate** – The Distribution Utilities shall bill their customers on the tenth (10) day of each month the System Loss Rates calculated in accordance with the immediately preceding Section.

## ARTICLE V

### VERIFICATION PROCESS

**Section 1. Monthly Reporting Requirements** – On or before the twentieth (20th) day of each month, the Distribution Utilities shall provide the ERC with all calculations related to Articles III and IV along with supporting documentations, which shall include, but not limited to, the following:

- Invoices from power suppliers;
- Sample bills to end-users;
- Official receipts of payment of power supplier invoices
- ERC Forms M-001 & M-002; and
- Other documents deemed relevant by the ERC.

**Section 2. Post Verification** – At least every six (6) months, the ERC shall verify the recovery of Generation Costs by comparing the actual allowable costs incurred for the period with the actual revenues for the same period generated by the Generation Rates and the portion of the Systems Loss Rates attributable to Generation Costs.

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Should the ERC fail to verify the Generation Rate (including the OGA) and System Loss Rate within six (6) months from the submission of calculation and supporting documentations in accordance with the immediately preceding Section, the rates shall be deemed final and confirmed.

Upon completion of the semi-annual verification process, the ERC shall issue an Order establishing the adjustments to be included in the OGA resulting from said semi-annual verification. These adjustments shall be implemented in the succeeding six (6) month period to reflect any over or under recovery.

**Section 3. Prior Verification of Other Generation Rate Adjustments (OGA).** OGA other than those included in Article V, Section 2 shall be verified and confirmed by the ERC within forty five (45) days from date of its filing and only thereafter shall they be recoverable.

## ARTICLE VI

### FINAL FILING UNDER THE GENERATION RATE ADJUSTMENT MECHANISM

**Section 1. Effectivity of the Generation Rate Adjustment Mechanism (GRAM)** – Upon the effectivity of these Guidelines, the GRAM shall no longer be applicable to Distribution Utilities.

**Section 2. Final filing under GRAM** – Distribution Utilities that are using the GRAM to recover Generation Costs shall file their final GRAM applications within sixty (60) days from the effectivity of these Guidelines. The final GRAM filing shall include the period from their last approved GRAM filing to the effectivity of these Guidelines for purposes of calculating the final Deferred Accounting Adjustment (DAA).

## ARTICLE VII

**Section 1. Fines and Penalties.** Violation of any provision of these Guidelines shall be subject to the imposition of fines and penalties in accordance with the Guidelines to Govern the Imposition of Administrative Sanctions in the Form of Fines and Penalties Pursuant to Section 46 of Republic Act No. 9136 promulgated by the ERC on May 17, 2002.

## ARTICLE VIII

### FINAL PROVISIONS

**Section 1. Exception Clause.** Where good cause appears, the ERC may allow an exception from any provisions of these Guidelines, if such exception is found to be in the public interest and is not contrary to law or any other related rules and regulations.

**Section 2. Separability Clause** - If for any reason, any part or section of these Guidelines is declared unconstitutional or invalid, the other parts or sections hereof which are not affected thereby shall continue to be in full force and effect.

**Section 3. Effectivity** - These Guidelines shall take effect on the fifteenth (15<sup>th</sup>) day following its publication in two (2) newspapers of general circulation.

SO ORDERED.

Pasig City, October 13, 2004.

  
**RODOLFO B. ALBANO, JR.**  
Chairman

(On Official Travel)  
**OLIVER B. BUTALID**  
Commissioner

  
**JESUS N. ALCORDO**  
Commissioner

  
**RAUF A. TAN**  
Commissioner

ORIGINAL SIGNED  
**ALEJANDRO Z. BARIN**  
Commissioner

**Copy furnished:**

1. **Philippine Electric Plant Owners Association (PEPOA)**  
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2. **PHILIPPINE RURAL ELECTRIC COOPERATIVES, ASSOC. (PHILRECA)**  
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**Quezon City**
3. **Office of the Solicitor General**  
134 Amorsolo Street, Legaspi Village  
City of Makati - 1229
3. **Senate Committee on Energy**  
GSIS Building, Roxas Boulevard  
Pasay City - 1300
4. **House Committee on Energy**  
Batasan Hills, Quezon City - 1126
5. **Department on Energy (DOE)**  
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6. **MS. HELEN B. ARIAS**  
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Fort Bonifacio, Taguig City
7. **Regulatory Operations Service (ROS) – ERC**
8. **Consumer Affairs Service (CAS) – ERC**
9. **ALL DISTRIBUTION UTILITIES (DUs)**