

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



IN THE MATTER OF THE  
APPLICATION FOR PRIOR  
VERIFICATION OF OTHER  
GENERATION RATES  
ADJUSTMENTS UNDER SECTION 3,  
ARTICLE IV OF THE GUIDELINES  
FOR THE AUTOMATIC ADJUSTMENT  
OF GENERATION RATES AND  
SYSTEM LOSS RATES BY  
DISTRIBUTION UTILITIES, WITH  
PRAYER FOR PROVISIONAL  
AUTHORITY

ERC CASE NO. 2009- 063 RC

PANAY ELECTRIC COMPANY, INC.  
(PECO) AND PANAY POWER  
CORPORATION (PPC),

Applicants.

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DOCKETED  
Date: DEC 02 2009  
By: *[Signature]*

**DECISION**

Before the Commission for resolution is an application for prior verification of other generation rates adjustments under Section 3, Article IV of the Guidelines for the Automatic Adjustment of Generation Rates and System Loss Rates by Distribution Utilities, with prayer for provisional authority, filed by Panay Electric Company, Inc. (PECO) and Panay Power Corporation (PPC) on September 15, 2009.

Having found said application sufficient in form and in substance with the required fees having been paid, an Order and a Notice of Public Hearing both dated September 22, 2009, were issued setting the same for hearings on October 19 and 20, 2009.

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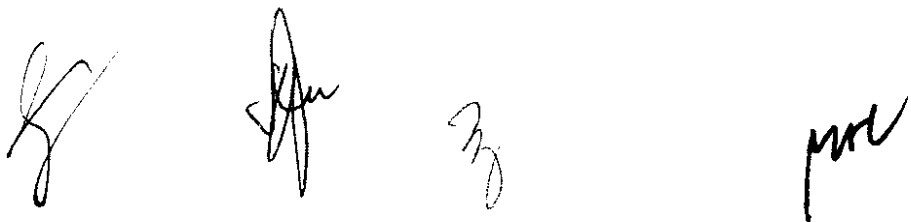
In the same Order, PPC and PECO were directed to cause the publication of the Notice of Public Hearing, at their own expense, twice (2x) for two (2) successive weeks in two (2) newspapers of general circulation in the Philippines, with the date of the last publication to be made not later than ten (10) days before the date of the scheduled initial hearing.

The Office of the Solicitor General (OSG), the Commission on Audit (COA) and the Committees on Energy of both Houses of Congress were furnished with copies of the Order and the attached Notice of Public Hearing and were requested to have their respective duly authorized representatives present at the aforesaid hearing.

During the October 19, 2009 initial hearing at the Iloilo Business Hotel, Glicerio Pison St., cor. Benigno Aquino Avenue, Mandurriao, Iloilo City, the following entered their appearances: 1) Attys. Amanda Bengson and Bernadette Villa-Policarpio, for PECO and PPC; and 2) Attys. Edgardo Gil and Noel Notiongayo, for the City Government of Iloilo as an Oppositor.

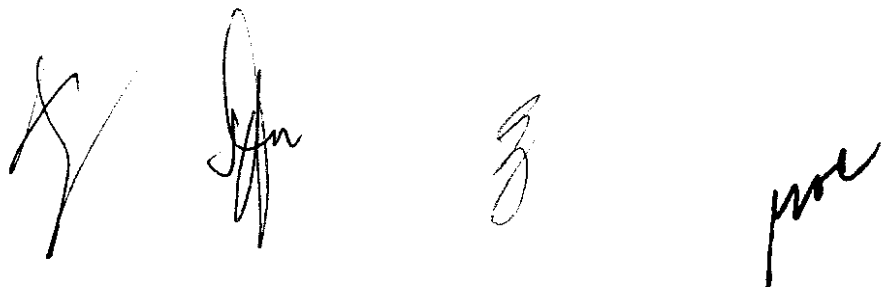
At the said hearing, PPC and PECO presented their proofs of compliance with the Commission's posting and publication of notice requirements which were duly marked as Exhibits "H" to "T-2", inclusive. Thereafter, they conducted an expository presentation of their application.

At the continuation of the hearing on October 20, 2009, only PPC and PECO appeared. They presented the following witnesses: 1) Engr. Randy S. Pastolero, PECO's Special Assistant to the President and CEO, who testified on



the source of PECO's power requirements from June 1999 to July 2005; reasonableness of PPC's rates vis-à-vis other diesel generating plants; and a comparison between the generation rates of PPC and NPC; 2) Mr. Niel V. Parcon, PECO's Comptroller, who testified on the invoices of PPC to PECO for the power purchased from May 1999 to June 2005 to support the basis for the computation of generation charge; 3) Mr. Jaime T. Azurin, the Senior Vice President and Chief Finance Officer of Global Business Power Corporation which holds 100% interest in Claredon Towers Holdings, Inc., the parent company of PPC, who testified on the following: a) The existence of the Power Purchase Agreement (PPA) dated January 24, 1997 entered into between PPC and PECO; b) The existence of the Letter Agreement dated June 20, 2003 executed by Mr. Ernesto Pantangco of PPC and conformed to by Mr. Jose Maria Cacho of PECO; c) The relation of the PPA with the Letter Agreement; and d) Invoices for both electricity fees and fuel billed by PPC to PECO and Official Receipts evidencing payments made by PECO to PPC; 4) Mr. Isaias Iziel A. Culanag, Jr., the Account Manager for Pilipinas Shell Corporation, who testified on the following: a) Supply and Equipment Agreement dated June 18, 1998 executed by PPC and Pilipinas Shell to prove the supply of petroleum products by the latter to the former; b) Payment terms and the process by which Pilipinas Shell obtains payment from PPC; c) Summary of the billings made by Pilipinas Shell to PPC; and d) Payments made by PPC to Pilipinas Shell covering the period January 1999 to July 2005.

The direct examinations having been terminated, the Commission propounded clarificatory questions on the said witnesses. Further, PPC and PECO were directed to submit various documents.



On October 29, 2009, PPC filed its "Compliance".

Thereafter, the Commission directed PPC and PECO to file their formal offer of evidence and the City of Iloilo to file its written opposition not later than November 6, 2009.

On November 6, 2009, PPC and PECO filed their "Motion to Admit Additional Evidence and Formal Offer of Documentary Exhibits" which are hereby admitted for being relevant and material to the resolution of this application.

## DISCUSSION

PECO and PPC filed a joint application for approval of the generation charge billed by PPC to PECO and consequently billed by the latter to its consumers covering the period May 1999 to July 2005 with the total amount of Php9,907,693,517.71.

In the said application, PPC and PECO alleged, among others, that:

- 1) The approved PPA dated January 24, 1997 provides the basis for the computation of PPC's generation rate which is composed of the monthly capacity payment, monthly energy payment and monthly fuel payment.
- 2) It is the intention of both parties not to peg PPC's generation rate to NPC rate prompting them to execute a Letter Agreement on June 20, 2003 which provides the formula in the computation of monthly generation rate.
- 3) They included Article 7.2 (2) in the PPA to ensure that PPC would sell power to PECO at competitive rates. The intent, however, was to base PPC's selling rates to PECO on existing generation rates being offered by bulk power producers similarly situated as PPC. These were bulk producers that (a) were located within the same grid as PECO, that is, the Cebu-Negros-Panay (CNP) Grid; (b) used bunker fuel as their primary fuel source; and (c) generated electric power using diesel power plants.



- 4) The generation rates being offered by bulk power producers that do not possess all of the above criteria are inappropriate benchmarks to determine competitive generation rates since the costs incurred by such bulk power producers are disparate from that incurred by bunker fuel-fired diesel power generating facilities located within the CNP Grid.
- 5) NPC was mentioned in Article 7.1 of the PPA merely as an example of a bulk power producer located within the CNP grid. They never intended that NPC rate would be their sole basis in determining the selling price of PPC to PECO because (a) NPC was not PECO's power supplier; and (b) the use of NPC rate as sole reference would result in a price distortion and unfairly reduce the generation rate of PPC to a level far below its actual costs.
- 6) In implementing the formula for the computation of Monthly Payment as contained in the Energy Regulatory Board (ERB) - approved PPA and the Letter Agreement, the resulting rates billed by PPC to PECO exceeded the rates of NPC starting the billing month of September 1999.

Shown below is the breakdown of the generation charge billed by PPC to

PECO:

GENERATION CHARGES (PhP)				
	1999	2000	2001	2002
January	-	87,856,087.28	113,997,141.44	117,208,613.66
February	-	84,371,998.71	106,935,622.75	105,437,370.25
March	-	94,571,020.79	122,991,906.00	117,539,861.50
April	-	93,829,678.47	119,943,143.00	128,771,782.75
May	66,029,129.39	101,641,091.18	128,466,777.25	134,991,411.25
June	65,805,460.56	99,479,484.82	120,744,017.25	129,347,266.75
July	67,186,909.44	99,182,566.98	114,819,743.22	127,498,329.75
August	73,175,437.72	101,445,497.23	117,630,567.25	127,435,718.88
September	75,363,597.40	103,318,937.65	122,269,936.58	122,210,969.46
October	83,048,564.14	109,609,175.03	127,583,970.58	135,789,014.48
November	79,903,056.35	112,249,557.08	114,650,879.20	127,409,765.90
December	87,833,861.92	113,857,893.76	118,373,942.50	128,670,322.55

	2003	2004	2005
January	124,528,331.10	150,073,371.04	169,893,242.41
February	120,645,037.10	143,460,058.05	161,325,692.37
March	149,171,607.20	167,742,359.98	179,549,074.14
April	152,170,209.84	165,670,942.86	194,074,753.75
May	154,199,973.50	172,948,754.88	221,013,802.91
June	151,939,392.96	163,187,274.24	219,478,201.67
July	155,300,085.50	178,952,168.87	227,721,859.43
August	160,211,380.00	175,733,520.95	-
September	154,166,305.00	175,572,774.50	-
October	159,426,245.26	172,390,864.16	-
November	156,684,709.40	170,410,193.90	-
December	147,684,204.77	181,881,045.87	-

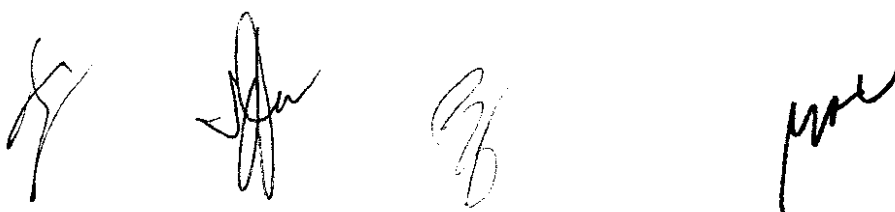
The subject joint application is anchored on the approved PPA between PECO and PPC which provides that:

**"Throughout the term of the Agreement, Panay Power's rates to applicant shall be equal to or less than the rates offered by bulk power producers in the grid such as NPC or its successor companies, provided that in the event that Panay Power's rates are no longer competitive with other bulk power producers, the parties hereto agree to conduct mutual discussions to resolve or minimize the effects of Panay Power's non-competitiveness. Said agreements shall, however, be subject to the ERB's approval."**

It can be gleaned from the foregoing provision that PPC's selling rates are not necessarily limited to the effective rate charged by NPC but may be based on the generation rates offered by other bulk power producers in the Panay Grid. It goes without saying, however, that such change in rate should bear the Commission's approval.

Records show that for the period May 1999 to May 2003, the billings and invoices of PPC have all been settled by PECO, as evidenced by official receipts. Based on these documents submitted, the Commission noted that PECO and PPC implemented a generation rate different from that approved by the Commission. PECO charged its consumers a higher generation rate which is different from that approved by the then ERB or the Commission.

PECO argued, among others, that due to the intervention and subsidy granted by the Philippine Government to NPC, the latter's rates do not reflect the true cost of generation and were distorted beyond what PECO and PPC contemplated when they executed the PPA. PECO argued further that based on



the circumstances existing at the time that the PPA was executed, PECO and PPC contemplated that "NPC rates" shall pertain to the unsubsidized and market-driven NPC rates, and not to its government-subsidized version. Thus, to require PPC and PECO to compete with or even match the present "NPC rates" would be harsh, unfair and inequitable, considering that NPC is subsidized by the government and could afford to operate at a loss while PPC cannot do so. PECO and PPC belabored to justify that the latter's selling rates are more reasonable compared to NPC's grid rate considering that its rates were based on the specific Operations Performance of NPC's Panay Diesel Power Plant (DPP).

Although PECO and PPC maintain that the PPA has not been amended nor modified, the deviation from the terms of the PPA may still be established on the basis of the Official Receipts billings and invoices submitted. PECO's subsequent act of charging its customers a rate different from that approved by the Commission, even if the said rate is assumed to be consistent with the approved PPA, is indicative that PECO and PPC have consented and agreed to change and implement the different rate without prior approval from the Commission.

In the case of *Kwong vs. Gargantos (507 SCRA 540)*, the Supreme Court ruled that:

"[T]he parties to a contract must expressly agree that they are abrogating their old contract in favor of a new one; In the absence of an express agreement, novation takes place only when the old and the new obligations are incompatible on every point."

In *MCC Industrial Sales Corporation vs. Ssangyong Corp., 536 SCRA 408*, the Supreme Court held that:



"[A]ppropriate conduct by the parties may be sufficient to establish an agreement, and while there may be instances where the exchange of correspondence does not disclose the exact point at which the deal was closed, the actions of the parties may indicate that a binding obligation has been undertaken."

Article 1292 of the Civil Code provides:

"Art. 1292. In order that an obligation may be extinguished by another which substitute the same, it is imperative that it be so declared in unequivocal terms, or that the old and the new obligations be on every point incompatible with each other."

Records further revealed that on June 20, 2003, PECO and PPC executed a Letter Agreement allegedly clarifying the pertinent provisions of their PPA. Said Letter Agreement brings to fore the issue of whether or not this Letter Agreement substantially modified the PPA as approved by the then ERB.

Although PPC and PECO refer to the Letter Agreement as a mere clarification to their original contract, the Commission is of the view that the said Agreement substantially modified/amended the PPA approved by the then ERB. A different and new rate was established in the said Letter Agreement particularly the base rate in the monthly capacity and energy payment and, thus, said Agreement in effect, amended the PPA.

"The test of incompatibility between two obligations or contracts is whether or not they can stand together, each one having an independent existence; if they cannot, they are not compatible, and the later obligation novates the first." (*Iloilo Traders Finance, Inc. vs. Heirs of Soriano, Jr.*, 404 SCRA 67 (2003)). "Novation is defined as the extinguishment of an obligation by substitution or change of the obligation by a subsequent one which terminates the first, either by changing the object or principal conditions, substituting the person of the debtor



or subrogating a third person with the rights of the creditor. The animus novandi, whether partial or total, must appear by the express agreement of the parties, or by their acts that are too clear and unequivocal to be mistaken.” (*Reyes vs. BPI Family Savings Bank, Inc.*, 486 SCRA 276)

“To determine if there was at least an implied novation because of a clear incompatibility between the old and new contracts, we apply the rule that –

In order that there may be implied novation arising from incompatibility of the old and new obligations, the change must refer to the object, the cause, or the principal conditions of the obligation. In other words, there must be an essential change.” (*Young vs. Court of Appeals*, GR. No. 83271, May 8, 1991).

Stemming from the provision of the Letter Agreement and the payments made by PECO to PPC, it can be said that the Letter Agreement has superseded the PPA, which is the original contract. With the execution and implementation of the Letter Agreement, PECO and PPC shall be bound to the fulfillment of their contract and the consequences thereof. As ruled by the Supreme Court in the case of *Department of Health vs. HTMC Engineers Company* (480 SCRA 299), “From the moment of perfection, the parties are bound not only to the fulfillment of what has been expressly stipulated, but also to all the consequences which, according to their nature may be in keeping with good faith, usage, and law.”

Simply put, although the PPA may not have been amended as the parties claim, the circumstances prevailing as well as the evidence presented speaks otherwise. While the justification for the imposition of a different generation charge may be well taken, the Commission is not swayed to countenance the wrongful act of imposing a different rate to consumers without obtaining prior approval from the Commission. The Commission deems it appropriate to deal with PECO’s wrong doing in a separate Order. This does not mean however that PECO and PPC are left without a recourse.



The Commission recognizes that generation charges are subject to reasonable and allowable adjustments. Hence, the Commission shall proceed to determine the reasonableness of the generation charge billed by PPC to PECO and consequently billed by the latter to its customers.

The test of reasonableness and prudence depends on the circumstances of the case with the end view of protecting consumers' interest while ensuring the viability of the DU's business.

"What is reasonable is not subject to exact definition or scientific formulation. No all-embracing test of reasonableness exists, for its determination rests upon human judgment applied to the facts and circumstances of each particular case."<sup>1</sup> "A just rate is founded on conditions that are fair and reasonable to both the public utility and the public. This stipulation means that the public utility must have, as profit, a fair return on the reasonable value of the property. The imposition of the maximum rates it charges cannot be confiscatory. As to the public, reasonableness requires entitlement to the service at an affordable cost."<sup>2</sup> "While this Court concedes the primacy of the public interest in an adequate and efficient service, the same is not necessarily to be equated with non-compensatory electricity rates or prices. Reasonableness in the rates assumes that the same is fair to both the public utility and the consumer."<sup>3</sup>

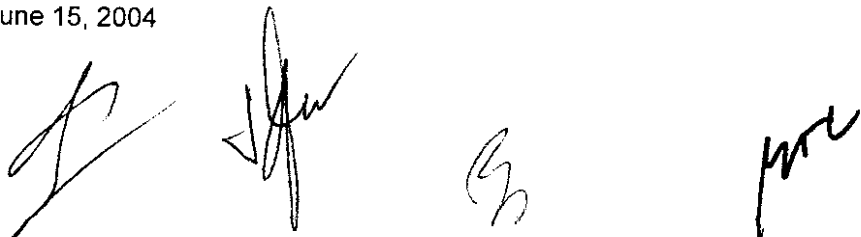
"The power lodged in the Commission to promulgate rates is a legislative power, and its exercise by the Commission involves legislative discretion and

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<sup>1</sup> Luzon Motorcyclists Federation vs. DPWH, G.R. No. 158793. June 8, 2006

<sup>2</sup> NPC vs. PEPOA, G.R. No. 159457. April 7, 2006.

<sup>3</sup> FDC vs. ERC, G.R. No. 161113. June 15, 2004



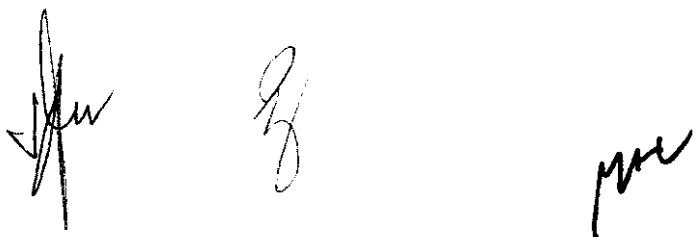
policy. Any rule that would require the Commission, before it promulgates any order fixing a rate, to have before it evidence that would establish to a mathematical certainty the reasonableness of the proposed rate, would greatly hinder, if not almost entirely prevent, the Commission from exercising that power.”<sup>4</sup>

Notably, the rate component of the approved NPC’s generation rate in the Visayas Grid comprises of the production costs of all types of its power plants such as diesel, hydro, geothermal and coal. To use the NPC effective grid rate as a sole reference for PECO’s power cost would result to price distortion and reduce the generation rate of PPC to a level far below its actual costs of operation. There being no existing contract to use as basis to evaluate the “reasonableness” of PPC’s generation charge for the period 1999 to 2003, it is more appropriate to recalculate PECO’s PCC using the Operations Performance of NPC’s Panay DPP which, under the circumstances the Commission finds similar with that of PPC Diesel Plant.

In compliance with the directive of the Commission during the hearing on October 20, 2009, PECO and PPC submitted on October 29, 2009, among others, the Operations Performance of NPC’s Panay DPP for the years 1999 to 2005. Said evidence was presented to prove the true cost of generation plants of similar technology to that of PPC’s 72 MW Diesel Fired Power Plant and to justify the generation rates it charged to PECO for the period 1999 to 2005. These documents were likewise submitted to prove the cost of bulk power producer in the island of Panay.

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<sup>4</sup> supra



The Commission evaluated the submitted evidence particularly, on the per unit generation cost of electricity of NPC's Panay DPP. A comparison was made between these documents and the actual generation charge of PPC. Accordingly, the result of the assessment of PPC and NPC Panay DPP's average generation charge (PhP/kWh) is as follows:

YEAR	1999	2000	2001	2002	2003
PPC	2.5796	3.6101	4.3056	4.3182	4.9052
NPC Panay DPP*	2.9560	-	3.6850	4.0980	4.5570

For purposes of comparison, it can be gleaned from the above table that the rates covered by the NPC Panay DPP data are lower compared to the average generation charge of PPC except for year 1999. Thus, the Commission computed PPC's generation cost for the period from May 1999 to Dec 1999 and years 2001-2003 using the cost of generation of the NPC Panay DPP or actual rate of PPC, whichever is lower.

As to year 2000, the Commission made use of the NPC rate in the computation of allowable generation cost considering that PECO & PPC were not able to provide supporting documents to justify the use of other generation rates other than NPC.

Shown below is the result of the simulation applying the foregoing:

Period Covered	Number of Months	PECO and PPC Generation Cost (PhP)	Commission's Computed Generation Cost (PhP)
May 1999 – June 2003	50	5,583,131,631.80	5,031,888,316.88

**A. For the Period July 2003 to July 2005**

As discussed earlier, the Commission deemed the subject Letter Agreement as an amendment to the PPA of PECO and PPC.

A comparison between the formula in the computation of the generation rate under the Letter Agreement with the approved Amended PPA showed that the former resulted to a lower rate. Accordingly, the Commission computed the generation cost covering the period July 2003 to July 2005 using the formula in the Letter Agreement.

Shown below is the computed generation cost of PPC to PECO covering the period July 2003 to July 2005.

Period	Number of Months	PECO and PPC Generation Cost (PhP)	Commission's Computed Generation Cost (PhP)
July 2003-July 2005	25	4,324,561,885.91	4,108,599,876.44

The table below shows the summary of calculation of the proposed generation cost of PPC to PECO covering the period May 1999 to July 2005:

Period	Number of Months	PECO and PPC Generation Cost (PhP)	Commission's Computed Generation Cost (PhP)
May 1999-June 2003	50	5,583,131,631.80	5,031,888,316.88
July 2003-July 2005	25	4,324,561,885.91	4,108,599,876.44
<b>TOTAL</b>	-	<b>9,907,693,517.71</b>	<b>9,140,488,193.32</b>

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**WHEREFORE**, the foregoing premises considered, the application filed by Panay Power Company, Inc. (PPC) and Panay Electric Company, Inc. (PECO) for prior verification of other generation rates adjustments under Section 3, Article IV of the Guidelines for the Automatic Adjustment of Generation Rates and System Loss Rates by Distribution Utilities is hereby **APPROVED with MODIFICATION**. Accordingly, PPC's approved generation cost to PECO amounts to **NINE BILLION ONE HUNDRED FORTY MILLION FOUR HUNDRED EIGHTY-EIGHT THOUSAND ONE HUNDRED NINETY-THREE PESOS AND THIRTY-TWO CENTAVOS (PhP9,140,488,193.32)** covering the period May 1999 to July 2005.

**SO ORDERED.**

**Pasig City, November 16, 2009.**

  
**ZENAIDA G. CRUZ-DUCUT**  
Chairperson

  
**RAUF A. TAN**  
Commissioner

  
**ALEJANDRO Z. BARIN**  
Commissioner

(Took No Part)  
**MARIA TERESA A.R. CASTAÑEDA**  
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