PERFORMANCE-BASED REGULATION (PBR): THE MODUS OPERANDI IN OVERPRICING POWER RATES UNDER DEFECTIVE PRIVATIZATION

EXPOSING THE MODUS OPERANDI IN UNLAWFULLY RAISING POWER RATES, EUPHEMISTICALLY CALLED PERFORMANCE-BASED REGULATION: INCLUSION OF DREAMS OF UNSPENT FUTURE CAPITAL EXPENDITURES IN PRESENT RATES

Evil Impact of PBR under EPIRA (RA 9136): Double Billing to Consumers, Unwarranted High Power Rates, and Meralco Rate of Return in Breach of Supreme Court-Ruled 12% Limit.

The ERC-approved performance-based regulation, implemented by Meralco and some other power distributors, is fatally flawed by a monumental defect: fallacious inclusion of future investments (or unspent future capital expenditures) and high asset replacement value in present power rates—but with easy-to-attain conditions as the basis for reward (like non-inclusion of a firm schedule of annual system loss reduction), with consequent unduly high power rates and annual rate of return in violation of the Supreme Court-ruled 12% reasonable-return limit for Meralco and other public utilities.91 In effect, the ERC-approved PBR unlawfully discarded the Supreme Court ruling.

The 12% rate-of-return ceiling for public utilities is the indispensable safety net of regulation that could have helped limit Meralco’s profits to a reasonable level, mandated by its franchise and the cited Supreme Court decision. Meralco’s operations with 12% reasonable return will automatically translate to the desired reasonable rate to consumers. If properly crafted—that is, without future investments and asset replacement value as components of present electricity rates—PBR can co-exist with a 12% profit-rate limit because they are not mutually exclusive. Unfortunately, as actually implemented, PBR has been the subterfuge for Meralco’s ever-rising power rates, with a rate of return way above—or more than double—the Supreme Court-ruled 12% profit-rate limit.

PART I
THE MONUMENTAL ERROR IN RAISING RATES FOR THE PAYMENT OF POWER DISTRIBUTOR’S DREAMS OF FUTURE CAPITAL EXPENDITURES

Meralco Can Dream to its Heart’s Content, But it is Absurd to Have Captive Consumers Pay for its Dreams

The corresponding increase in power rates for unspent future capital expenditures as well as unrealized increase in asset replacement cost, justified through ERC-approved PBR, is unlawful and unsound economics, for the following reasons:

1. The PBR dubiously anchored on the vague provision of Section 43 (f) of EPIRA is a mere rate-setting method; it cannot override the Supreme Court ruling on 12% maximum return for Meralco and other public utilities, the EPIRA provision on power rates based on the recovery of prudent and reasonable costs incurred, and Meralco’s own franchise which mandates it to charge rates in the least cost manner; therefore, PBR cannot validly authorize the rate increase for unspent future capital expenditures because doing so is contrary to existing laws and jurisprudence.

The ERC-approved PBR is not right because it has simply served as a subterfuge for Meralco’s violation of the Supreme Court ruled 12% profit-rate limit, with a drastic rise in its net income at the sacrifice of poor consumers.

“The ERC approval of the performance-based rate-making (PBR) is one reason for the soaring rates on the distribution side.... The opening for an ‘alternative methodology’ provided by Section 43 (f) of the EPIRA led to the junking of the more transparent return on rate base (RORB) and the adoption by the ERC of PBR. Under PBR, a distribution utility is allowed a return on investment on installed facilities and future investments. The future investments are not mandatory as long as the utility achieves a level of ‘performance.’ It will be penalized if it doesn’t achieve this level of performance (thus the nice name ‘performance-based’). When Meralco announces a multibillion-peso capital investment, the consumers are hit twice—they pay for it and give the utility a return on investment that was already part of the rate base or historical costs.
“In the first year of PBR, Meralco gained an additional revenue of P6 billion although it ‘suffered’ a P300-million penalty for nonperformance.... PBR, which allows recovery on investments not yet made by Meralco, is contradictory to Section 25 of the EPIRA which says that ‘retail rates shall be based on the principle of full recovery of prudent and reasonable costs incurred.’ If the regulators’ hearts were in the right place, the operative word should be ‘incurred’ costs. Projected investments are not costs incurred but allowed by PBR, resulting in undeserved profits for the distribution utility and an unfair burden on the consumers. Although Section 25 also provided an opening for ‘such other principles that will promote efficiency as may be determined by the ERC,’ it behooves the regulatory agency to construe this strictly to the best interest of the electricity end-users. As it is, PBR promotes efficiency only in overcharging the consumer.” 92

As an alternative methodology under Section 43 (f) of EPIRA, PBR is just that—an alternative pricing methodology or rate-setting method that is neither specifically named nor described in this law. PBR as a rate-setting method is different from a rate-of-return limit. PBR as a mere interpretation of a vague Section of EPIRA cannot repeal by implication or override the Supreme Court-ruled 12% reasonable return limit for Meralco and other public utilities.

The Later Special Law, Meralco’s Own Franchise, RA 9209 Enacted on June 9, 2003, Which Provides the Rules on Meralco’s Rate-Setting Process, Should Prevail Over the Cited Vague Provision of Section 43 (f) of EPIRA, Enacted on June 8, 2001

According to CPA David Celestra Tan, the “opening for an ‘alternative methodology’ provided by Section 43 (f) of the EPIRA led to the junking of the more transparent return on rate base (RORB) and the adoption by the ERC of PBR.” The cited legal basis of the ERC-approved PBR is vague and general in nature. It cannot prevail over the specific provisions of the later special law, Meralco’s franchise, RA 9209. Section 4 of Meralco’s franchise provides as follows: “Responsibility to the Public. - The grantee shall supply electricity to its captive market in the least cost manner.... The grantee shall charge reasonable, just and competitive power rates for its services to all types of consumers within its franchised area so that business and industries shall be able to compete....”

Certainly, Meralco’s unwarranted and avoidable rate increase under PBR does not comply with the least-cost requirement in its own franchise.

92 David Celestra Tan, “Epira an imperfect law imperfectly implemented.”

Comparative Statements of Income
Under Power Rates WITH and WITHOUT
Inclusion of Future Capital Expenditures

To visualize just what is wrong and abnormal in performance-based regulation or PBR, shown below with hypothetical numbers is a simplified comparison of Income Statements under two schemes—PBR as an unorthodox method with inclusion of unspent future capital expenditures in power rates, and the conventional method without the inclusion of such unspent expenditures in its pricing method.

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<th>Conventional</th>
<th>PBR</th>
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<tr>
<td>REVENUE</td>
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<tr>
<td>Sales</td>
<td>₱100</td>
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<tr>
<td>Recovery of unspent future investments</td>
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<td>20</td>
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<tr>
<td>Total</td>
<td>100</td>
<td>120</td>
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<tr>
<td>COSTS and EXPENSES</td>
<td>80</td>
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<tr>
<td>NET INCOME</td>
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The comparison clearly shows that without any extra effort, additional cost, and efficient operations on its part, Meralco earns undeserved higher revenue and net income under PBR, through the simple expediency of including in power rates its plans of future capital expenditures. The higher net income is distributable as dividends to stockholders at their whims. Therefore, if distributed as dividends, by this time, the bulk of the increase in income from the increase in power rates for future investments would not even be with Meralco anymore. In effect, ERC has unduly compelled millions of victimized power consumers—including the government (its agencies, corporations, local government units, and ERC itself as a collectively large power consumer in Meralco’s franchise area)—to make advanced payments to the power distributor for its plans, nay dreams, of future capital projects, which are not yet prudent and reasonable costs incurred as required under Section 25 of EPIRA.

The inclusion of consumers’ advance payments for future investments in existing power rates through PBR is not a valid rate increase. Under it, Meralco charges consumers for recovery of costs not yet incurred. It results in double billing to consumers, and it is a major contributor to the power distributor’s breaching of the 12% reasonable return limit mandated under the cited Supreme Court ruling dated November 15, 2002, affirmed on April 9, 2003. It also defeats the purpose of government privatization by shifting the financing burden for the construction of future expansion projects from private capitalists to consumers. The consumers should shoulder the depreciation expense on completed capital projects, not their construction financing.
2. The concomitant illegality—or violation of the Supreme Court-ruled 12% reasonable return limit for public utilities—caused by the inclusion of future investments in existing power rates arose from ERC’s failure to CONSULT real ACCOUNTING EXPERTS on the propriety of inclusion of Meralco’s DREAMS of unspent future capital expenditures in power rates, thereby resulting not just in ERC’s WRONG APPROVAL of the WRONG PBR METHOD but also in WRONG MECHANICS of IMPLEMENTATION.

How the Legal and Economic Fallacies of Inclusion of Future Capital Expenditures in Existing Power Rates Arose in the Past

a. Meralco instituted a WRONG BILLING METHOD for the rate increase for future capital expenditures.

Meralco’s monthly bills to customers included the rate increase for future capital expenditures in its regular power rates. The correct method is to unbundle or show separately the special rate increase in its monthly bills for proper recording purposes.

b. As a consequence of the wrong billing method, a WRONG RECORDING METHOD for the rate increase followed.

The special rate increase was erroneously recorded as part of regular sales or revenue in Meralco’s accounting records or books of accounts. Had the rate increase been shown separately, it should have been recorded as a trust account or liability, for which Meralco will be accountable to ERC and consumers for its proper utilization exclusively for the intended projects, with any future excess refundable to consumers.

c. Meralco’s wrong recording method resulted in the WRONG INCOME STATEMENT TREATMENT of the rate increase.

With Meralco’s special rate increase recorded as part of its regular revenue account, it was improperly included as part of its Revenue and Net Income in its annual audited Statement of Income. It should not have been included in its income statement because, as stated, it should have been treated as Meralco’s trust liability, includible in its Balance Sheet but not in its Income Statement.
d. The wrong Income Statement treatment of Meralco’s rate increase as part of Revenue and Net Income provoked the WRONG BALANCE SHEET PRESENTATION of the billed rate increase as Meralco-owned CURRENT-ASSET Cash in Banks and Accounts Receivable in the Asset side and as Retained Earnings (part of Stockholders’ Equity) in the Liabilities and Capital side—with a risk of being distributed as DIVIDENDS to stockholders, to be made up for by loans with interest cost borne by consumers.

Meralco’s rate increase, which erroneously forms part of its Net Income in its Statement of Income, is presented in turn in its Balance Sheet (Statement of Financial Position) as company-owned Cash in Banks in the Asset side and as Retained Earnings under Stockholders’ Equity in the Liabilities and Capital side. As part of company-owned Retained Earnings, the rate increase can be distributed as dividends to stockholders, thereby defeating its purpose of providing funds for future capital expenditures.

e. With the wrong Balance Sheet presentation of the collected rate increase as part of Current-Asset Cash in Banks—not as Trust Fund from consumers—in Meralco’s accounting records, there will be final WRONG RECORDING of the completed FIXED-ASSET capital projects where the Cash in Banks was spent as MERALCO ASSETS, not those of consumers who previously paid for them as rate increase.

Because the rate increase paid by consumers is erroneously shown in Meralco’s Balance Sheet as Cash in Banks owned by it, not as Trust Account for the benefit of consumers where the cash originated as a rate increase, upon disbursement of the Cash in Banks to pay for actually constructed and completed capital projects, there will be a wrong recording of the completed projects in Meralco’s Accounting records as its own fixed assets, entitled to depreciation-expense and 12%-return recoveries from consumers, even if they already paid for the assets out of power rates.
f. The wrong Balance Sheet presentation of the completed projects as Meralco FIXED ASSETS means that Meralco is entitled to rate increase for cost recovery and return on those assets. As Meralco is traded in the stock market, this will cause damages to misled investors once the rate-increase recording is corrected as a TRUST ACCOUNT.

The wrong recording in Meralco’s books of accounts of the consumer-financed completed capital projects as Meralco Fixed Assets entitled to a rate increase for cost recovery and 12% reasonable return is misleading precisely because it is wrong. The original rate increase should be recorded in Meralco’s books and treated in its financial statements as Trust Account or Liability, capital projects financed from which are no longer subject to second recovery from consumers as depreciation expense. This is a Meralco accountability that should be used for the purpose intended, with any excess refundable to consumers. There should be a retroactive correction of all past erroneously recorded rate increases to do justice to aggrieved consumers. This is a must in a decent and enlightened society. The earlier this correction is done, the less stock investors are deceived.

3. As the ultimate result of the foregoing error after error in Meralco’s billing method, recording, and financial-statement presentation of the fallacious rate increase for future capital expenditures, the UNORTHODOX PRICING METHOD will spawn future DOUBLE, nay MULTIPLE, Meralco BILLING to victimized generally poor power consumers—the poison fruit of the erroneous final recording and treatment of the consumer-paid completed projects as Meralco-owned ASSETS, with consequent WRONG BILLING again to consumers of the depreciation-expense recovery and return on investment on the completed projects.

To elaborate, here is how the wrong and unfair scheme of including FUTURE capital investments in power rates will produce DOUBLE—or even MULTIPLE—BILLING to consumers:

a. First charge: at present, as part of the existing power-rate component for future capital expenditures.

b. Second charge: in the future, as part then of power-rate component for depreciation on completed projects, with the projects previously paid for not by Meralco but by consumers as a power-rate component
for future capital investments. (Total cost of the completed project is recovered over its service life in years through annual depreciation, which forms part of service rate or selling price.) With the consumers’ payments for future investments recorded and treated as sales revenue or INCOME owned by Meralco, its use of the consumers’ payments to pay for future completed projects will result in the completed projects being recorded and treated as owned by the power distributor.

Consequently, Meralco will be entitled to recover again from consumers through future rate increase the cost (in the form of annual depreciation) of the future completed projects already paid for by consumers as future investments.

c. Third charge: in the future, Meralco will be entitled likewise to charge consumers for return on investment in the future completed projects, with the completed projects paid for by consumers—not by Meralco—but recorded in Meralco’s books of accounts as owned by it.

d. Fourth charge: in the future, as the future capital projects once constructed and completed will produce additional deliverable volume (kWh) of electricity, with consequent capacity expansion in new service areas, existing consumers in the old service areas will be charged for the cost of expansion in the new service areas. Thereafter, the new customers in new service areas will be similarly charged for depreciation recovery and return on investment, even if the project was already paid for by consumers in the old service areas—because the consumer-financed completed projects are erroneously reflected in Meralco’s books as owned by it.

In sum, to recover the investment on the assets erroneously recorded as Meralco-owned together with a reasonable return thereon, consumers have to be charged again for depreciation expense plus allowable 12% return through increased power rates, even if the assets were previously paid for by consumers—not by Meralco—as increase in power rates under fallacious PBR.

The foregoing actual and impending cases of multiple billing clearly show the witting or unwitting deception involved in rate-hike petitions for unspent future capital expenditures without regard whatsoever to such multiple billing. The CPAs among ERC commissioners should have corrected this blunder in PBR but did not.
4. The case of consumers paying in advance to finance future capital investments goes against the spirit and intent of PRIVATIZATION: shift the financing burden to private investors who will reap profits from privatization—and who professed during pre-bidding prequalification of bidders that they are financially capable of performing the obligations of a franchise grantee.

If the rate increase is to have consumers help power distributors finance the cost of future capital projects, this goes against the objective and assumption of government privatization—that private investors would assume funding responsibility for future investments and operations, and that the investors are technically and financially capable and qualified companies.

As in the case of MWSS privatization (p. 231), the objective of privatization in the power industry is precisely to shift the financing burden to private investors, away from government and the people. Meralco as a private investor and franchise grantee—not its consumers—is responsible for funding its future capital investments. If consumers and not Meralco stockholders will be responsible for funding its future investments, then why privatize at all, why give this lucrative business to private investors who will merely fry consumers in their own lard, so to speak?

5. The rate increase for future capital expenditures that will increase production capacity is erroneous—because the cost of completed capital projects that raised production capacity will be recovered from the increase in sales volume to new customers that increases total sales amount even without an increase in selling price per unit; raising the rates of consumers serviced by the old production capacity results in overbilling to them.

To illustrate: Assume that an existing unit of school bus serves 20 students and, the following school year, additional 20 students will be served, thereby bringing total customers to 40 students. In this case, the acquisition cost of the needed second school bus will be recovered from service fees to the additional 20 students. The existing fees to the present 20 students will not be raised or doubled, otherwise, both the first 20 and the second 20 students will be charged for the second school bus, with double billing to the first 20 students. The same overbilling happens if Meralco power consumers in Metro Manila are charged for capital expenditures in expanding to new franchise areas, like Bulacan. A distinction should be made then on capital expenditures because those for capacity expansion do not warrant a rate hike.
6. The rate increase to consumers for Meralco’s future capital expenditures is not right, but if it is rammed down the throats of unprotected consumers, at the very least, it should be properly recorded and treated in Meralco’s books as its accountability and TRUST LIABILITY, to be deposited in an interest-earning ESCROW bank account, subject to future accounting of actual utilization, with any excess refundable to consumers together with accrued interest income.

The rate increase for future investments should be separately recorded and treated as a trust fund—or liability to consumers—in Meralco’s books of accounts and financial statements. It is a liability because Meralco has the obligation and accountability to use the fund only for the specific purpose of the rate increase and to return to consumers any eventual surplus amount. Otherwise, the excess portion of the rate increase will be simply for profiteering purposes.

Unfortunately, as stated, the rate increase is recorded and treated as revenue or income in Meralco’s books and financial statements. As income, the cash generated is mingled with regular company funds. Whether used or unused, the accumulated rate increase is no longer Meralco’s accountability to consumers. Worse, Meralco can declare it as dividends to stockholders—ininstead of using it for future investments—in the process making the rate increase useless for its purpose. With Meralco’s cash partly depleted from the declaration of the rate increase as dividends, it has to borrow replacement funds from banks, for which it will charge again the hapless consumers for interest expense as part of cost and expenses.

While treating the subject rate increase as a trust fund or liability is better than the present practice of treating it as the power distributor’s income, doing so is not recommended because, as previously stated, it will unduly shift Meralco’s funding responsibility to consumers. Private investors in Meralco should live up to their professed financial capability and committed funding responsibility when they were applying in the past as power distributor in Meralco’s franchise area.
PART II

THE TECHNICAL ERROR IN RAISING RATES
FOR THE PREMATURE RECOVERY FROM POWER
CONSUMERS OF UNSPENT FUTURE INCREASE IN
REPLACEMENT COST OF MERALCO’S FIXED ASSETS

Are ERC officials blissfully unaware of the double billing to consumers through the use of high asset replacement value—instead of low historical cost—in setting power rates under the ERC-approved PBR?

Under ERC’s approved PBR, the power-rate components for recovery of investment and return thereon are calculated based on high asset replacement value, hence PBR bred further increase in already high power rates. An advocate of this method justified it as follows:

“The current standards on accounting for Property, Plant and Equipment (PP&E) is International Accounting Standards (IAS) #16, which expressly allows the use of historical cost or replacement value in the valuation of PP&E. IAS #16 also states that the alternative basis for valuing assets when these are rarely sold except as part of a continuing business is a depreciated replacement cost (DRC) approach…. The fair return on the DUs’ investment in system and non-system network supply assets should thus be determined using replacement value. The historical cost can only be used if it closely approximates the replacement value. This, however, is unlikely in countries like the Philippines, where inflation rates have been historically higher than the more developed countries, and where most of the system network supply assets are imported using foreign exchange which fluctuates widely vis-à-vis the Philippine peso. Investments in the system network are of a continuing nature, and this would not be served if the investors feel that they are not receiving a fair return. The benefit to consumers of using historical cost that could result in lower electricity rates may be short-lived because investments in network expansion would not happen if the depreciation expense using such historical cost is not sufficient to fund the required reinvestments to sustain the network.”

The replacement-value pricing may apply to ordinary or non-essential products but not to basic necessities in captive markets. If a new power distributor in a new franchise area can operate with new high-cost facilities, Meralco in its existing franchise area can do the same. When that happens, that will be the time for it to apply for rate increase to recover the high cost of new assets.

1. Meralco’s substantial increase in asset REPLACEMENT VALUE was due to peso depreciation during the Asian meltdown, with consequent exchange losses on foreign loans used to acquire the assets, which losses were already charged to power consumers through the FCDA and CERA mechanisms; charging consumers again for higher depreciation owing to revaluation of assets will constitute DOUBLE BILLING.

The main root of the increase in replacement value of Meralco’s assets was the drastic peso depreciation during the 1997-1998 Asian crisis that resulted in exchange losses on foreign loans, high inflation, and higher asset replacement values. As the increase in asset values was provoked mainly by inflation from peso depreciation, with equivalent foreign-loan exchange losses already recovered by Meralco from power rates through the Foreign Currency Differential Adjustment (FCDA) mechanism (later changed to or duplicated by Currency Exchange Rate Adjustment or CERA), using depreciated replacement value (that is, sound value) of assets as basis of depreciation-recovery and return-on-investment components of power rate would, therefore, entail DOUBLE BILLING to consumers.

**1st Case of Double—nay, Triple—Billing**

On the increase in asset replacement value, the first case of multiple cost recovery from consumers consists of the following:

(a) past recovery through FCDA and CERA of the exchange losses on unhedged foreign loans used to acquire the subsequently revalued assets;

(b) present depreciation-recovery and return-on-investment components of power rates for the increase in replacement value of the revalued assets, which increase in value—in the form of exchange loss—as reflected in the peso equivalent of the foreign loans used to acquire the assets, was already recovered through the cited FCDA and CERA;
(c) in the future, when the present rate increase for higher asset replacement value is eventually used to acquire or build higher-cost replacement assets, the portion of the future replacement assets already paid by consumers out of FCDA, CERA, and the present rate components for depreciation recovery and return on investment, will be entitled again to depreciation recovery and return on investment in future power rates chargeable to consumers.

2nd Case of Double Billing

On increase in asset replacement value not yet recovered through FCDA or CERA as this was not part of past exchange losses on foreign obligations, in the future, when the present rate increase for higher asset replacement value is eventually used to acquire higher-cost replacement assets, the portion of the future replacement assets already paid by consumers out of present rate increase, will be entitled again to depreciation recovery and return on investment chargeable to consumers under future power rates.

2. Under normal conditions without extraordinary exchange losses, it is also unwarranted to use higher asset REPLACEMENT VALUE—instead of lower historical cost—in rate-setting for monopolies and oligopolies operating in captive markets imbued with public interest; doing so will entail DOUBLE BILLING and MISMATCHING of COST spender and BENEFIT receiver.

To repeat what I have long advocated, economic solutions should be condition-oriented—meaning, pricing based on higher asset replacement value should not be applied uniformly to all industries with varying conditions. We probably need not mind applying the cited International Accounting Standards (IAS) No. 16 to the pricing—based on revalued assets—of thousands of ordinary and non-essential products sold in free market, but not in the case of few all-important basic necessities like power and water, unavoidably needed daily by generally poor mass consumers, millions upon millions of them nationwide.

To the extent practicable, to attain the greatest good for the greatest number, regulation of crucial basic necessities should include setting prices as accurately as possible at the optimum lowest level, within the range of required reasonable return to investors and reasonable rates to consumers. To attain this objective, considering the billions of pesos involved in possible double billing in the big-business power and water industries, in their rate setting, government regulators should properly match those who bear the cost and those who benefit from it, to achieve accuracy and fairness in regulated utility rates. This is a very important rule that is wantonly violated under regulatory pricing based on higher asset replacement value.
As an example, let us assume that come replacement time, 40% of the cost of a public utility’s new replacement assets was sourced from—or paid for over the years by—consumers as heretofore increase in service rates, aimed at recovering increase in depreciation expense that arose from the recorded revaluation of assets at higher replacement value. In this case, while only 60% of the new asset replacement cost will come from the public utility’s stockholders, they will benefit from and recover from consumers as annual depreciation expense the 100% higher cost of new replacement assets, even if 40% of such total cost was paid for not by them but by consumers. Worse for consumers, they previously paid for the 40% cost as unspent future capital expenditures, yet it will be charged to them again—this time as depreciation expense recovery of the now spent capital expenditures or completed projects previously paid by them. \textit{This double billing to consumers is due merely to ERC’s shortcomings and should be promptly corrected.}

3. Using Higher Asset REPLACEMENT VALUE in Rate Setting Will Have Consumers Unduly Assume Part of Future FUNDING RESPONSIBILITY of Existing Power Companies

The assertion that using historical cost as the basis of recovering past capital expenditures will not enable Meralco to fund future higher asset replacement cost implies that Meralco is incapable. It suggests that Meralco should have a reserve fund for future higher cost of replacement assets, but the reserve fund should come from consumers, not from Meralco stockholders. The claim is based on assumption contrary to fact and unfair to consumers.

Against the backdrop of existing investors with business assets acquired at old costs, new investors venturing for the first time in industries new to them (without reserve fund derived from increased prices for higher replacement costs of old assets) can compete and prosper even if their new assets were acquired at current higher costs. We have such cases and examples in the power industry itself, in the oil industry, in the airline industry, in the telecom industry, and many other industries. \textit{ERC can authorize Meralco to charge higher rates in the future as and when it incurs higher new asset replacement costs.} In which case, there is no reason why Meralco cannot obtain the needed funding from its stockholders and creditor banks, just like what new private investors in industries new to them are doing and can do.
4. Using Higher Asset REPLACEMENT VALUE in Rate Setting Will Have Consumers Provide Reserve Fund to Meralco for its Future Asset Replacement Program, But Such ASSET REPLACEMENT by Meralco May NOT Even Take Place Because it is Contingent Upon the Uncertain Extension of Meralco’s 25-Year Franchise

Consumers should not advance to Meralco part of the cost of its future asset replacement program through fallacious use of higher replacement value in its rate-setting. Such asset replacement may take place beyond Meralco’s present 25-year franchise. For purposes of charging consumers, it is not right to have them pay for something that may or may not happen. We cannot definitely conclude that future lawmakers will extend Meralco’s franchise instead of awarding it to other private investors, or to the government as a reversal of privatization. If Meralco’s franchise is not renewed, the consumers will suffer in vain for their higher rate payments to Meralco through the present use of higher replacement value in Meralco’s rate-setting. What’s more, such higher rate payments violate Meralco’s franchise which mandates it to charge the least rates to its captive customers.

5. If Meralco’s recorded total appraisal increase for higher replacement values of its property and power distribution facilities includes that of its lands in various locations, which are non-depreciable assets and do not need future replacement at higher acquisition cost, then the land appraisal increase as inclusion in present power rates to take care of higher future asset replacement cost is definitely wrong.

In 2006, Meralco had its assets appraised by Asian Appraisal Company preparatory to revaluation as a basis for upward adjustment in power rates. Included in the revaluation was the increase in the P623.4 million recorded historical cost of its land assets to P6.6 billion replacement cost. As parcels of land are non-depreciable assets and do not need future replacement, any inclusion of an increase in land replacement cost as part of increase in Meralco rates for asset revaluation in 2006 is obviously wrong and deceitful.
The Unimplemented Proper PBR

In sum, the inclusion of unspent future investments and higher asset replacement cost in present power rates under PBR is utterly wrong and, therefore, unwarranted. It is out-and-out taking advantage of the lack of adequate information and technical expertise of majority-poor power consumers, who are too busy eking out a living under our adverse economic conditions. They generally do not have the time and training needed to look at the validity and accuracy of recurring power rate increases.

The Supreme Court-ruled 12% reasonable return to regulated public utility monopolies is the ceiling or maximum allowable return on invested capital, but it is not a guaranteed profit rate. To attain it, regulated companies have to perform well and attain targeted annual work program and operations—such as a prescribed annual reduction in system losses—and this is the real challenge and correct PBR to them, not the absurd and fallacious allowing of a rate increase for future capital investments, for which the public utilities have not performed anything or spent a single centavo to warrant a present rate increase. This blatant scamming of consumers—including the government itself as a power consumer—by big business has to stop!

THE SUPREME COURT HAS VOIDED ERC’S ADOPTION OF REPLACEMENT COST IN THE VALUATION OF MERALCO’S REGULATORY ASSET BASE

To quote from the Supreme Court’s recent self-explanatory decision on the matter, on the case National Association of Electricity Consumers for Reforms, Inc. vs. Energy Regulatory Commission, Manila Electric Company, and Commission on Audit, G.R. No. 226443 dated October 8, 2019:

“WHEREFORE... We VOID the adoption by the Energy Regulatory Commission of the current or replacement cost in the valuation of Manila Electric Company’s regulatory asset base. We REMAND this case to the Energy Regulatory Commission to determine, within ninety (90) days from finality of this decision, (1) the valuation of the regulatory asset base of Manila Electric Company, and (2) the parameters whether expenses that are not directly and entirely related to the operation of a distribution utility shall be passed on wholly or partially to consumers, all to the end that the electricity shall be provided to consumers ‘IN THE LEAST COST MANNER,’ in accordance with this Decision.”