

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



**IN THE MATTER OF THE
APPLICATION FOR THE APPROVAL
OF ANCILLARY SERVICES – COST
RECOVERY MECHANISM (AS-CRM)
OF THE ANCILLARY SERVICES
PROCUREMENT PLAN, WITH
PRAYER FOR PROVISIONAL
AUTHORITY**

ERC CASE NO. 2006- 049 RC

**NATIONAL TRANSMISSION
CORPORATION (TRANSCO),
Applicant.**

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Date: DEC 01 2007
By: [Signature]

DECISION

Before this Commission for resolution is the application filed by the National Transmission Corporation (TransCo) on September 11, 2006 for the approval of its Ancillary Services – Cost Recovery Mechanism (AS-CRM) of the Ancillary Services Procurement Plan (ASPP) with prayer for provisional authority.

In the said application, TransCo proposed, among others, the following mechanisms and formulae on the implementation of its AS-CRM of the ASPP:

Ancillary Services – Cost Recovery Mechanism (AS-CRM)

1.0 Introduction

The Ancillary Services – Cost Recovery Mechanism (AS-CRM) completes the Ancillary Services Procurement Plan (ASPP, Order on ERC Case 2002-253 dated July 12, 2006) and is consistent with the Open Access Transmission Service (OATS) Rules.

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1.1 Overview

There are three (3) modes for a customer to secure any or all of their ancillary services. First is through TransCo's Ancillary Services Procurement Agreement with qualified generation companies; second is through the market, subject to the methodologies approved by the Energy Regulatory Commission (ERC) - the Market Rules (Section 3.3.3.5) allows trading and settlements of all types of Ancillary Services; and third is through the Alternative Ancillary Services Arrangement with another service provider.

For services arranged through TransCo, the OATS Rules (Section D7) and the ASPP and the AS-CRM will be applied.

In cases where customers opt to secure any or all of their ancillary services requirements through the Wholesale Electricity Spot Market (WESM), procurement and recovery of costs shall be independent of TransCo.

In cases where customers opt to secure any or all of their ancillary services requirements through an Alternative Ancillary Services Arrangement, procurement and recovery of costs shall be independent of TransCo provided that the arrangement is approved by TransCo. In such cases, Section D8 of the OATS Rules shall apply.

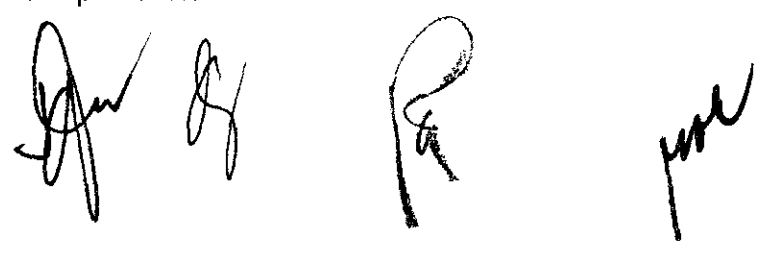
Effectively, the decision of where to secure the required Ancillary Services rests on the customer. Availing a particular ancillary service through TransCo will not in any way preclude the customers from availing the rest of their ancillary requirements through WESM or through an alternative ancillary service agreement.

1.2 Principles in the Design of the AS-CRM

The AS-CRM sets the rules on TransCo's recovery of ancillary services contracted and procured under the ASPP. The AS-CRM remains consistent with TransCo's mandate under Republic Act No. 9136 and its Implementing Rules and Regulations (Electric Power Industry Reform Act of 2001) and ERC-approved OATS Rules.

The following are the general principles used in the formulation of the AS-CRM:

- (a) Revenue Neutrality. The formula should be revenue neutral to both System Operator and Market Operator. There should be no under and over recovery of the cost of service and no profit margin will be allowed. That is, the charges should be complete passed-on from the user or beneficiary of the service to the service provider.



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- (b) "Causers Pay" Principle. The principle of "causers pay" should apply whenever practical. This means that if the necessity of a certain Ancillary Service can be attributed to a particular user or beneficiary, the cost of that service should be charged accordingly. Otherwise, the cost should be allocated in proportion to the level of transaction in the grid. However, charging the cost of Ancillary Services, the "causers pay" principle based on Generator vs. Customer cost allocation may be immaterial considering that Generators will always impute all costs when they charge the Customers or bid into the WESM.
- (c) When allocating cost for Ancillary Services, the timeframe for system averaging should be as close as practicable (i.e., coincident) to the time the services are being provided or made available to the system. For example, the cost allocation of reserve should be based on the hourly energy schedules instead of using monthly peak demands.

Ancillary Services that are allowed to be traded in the WESM will have cost recovery formulations for both the OATS and WESM regimes to provide a transition while the latter is still under development. Other types of services not covered by the WESM will adopt the rates and charges as stipulated in the OATS although this does not preclude TransCo from using the WESM formulae.

1.3 Definition of Terms

The terms used in this AS-CRM is consistent with Section A1 of the OATS Rules (Defined Terms and Interpretation).

1.4 Definition of Ancillary Services

The labels used to describe the ancillary services vary. TransCo, in its 2004 OATS Rules, follows the labels for different ancillary services used in the Grid Code. However, the WESM Rules differ in their labels or terms in some of the ancillary services.

In the interest of consistency and avoidance of confusion, the terms are reconciled with due consideration to relevant system requirements such that reliability and quality of service are not compromised. Table 1.1 below shows an equivalence matrix of the definition of each service.

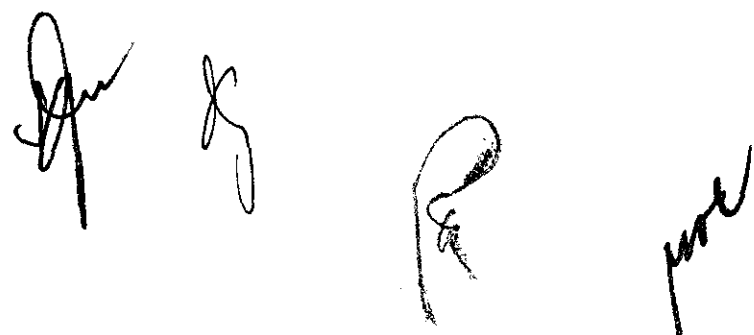


Table 1.1 Definition Matrix for Ancillary Services

2004 OATS Rules	2006 OATS Rules	WESM Rules
Load Following and Frequency Regulation	Regulating Reserve	Regulating Reserve
Contingency Reserve Spinning Reserve	Contingency Reserve	Contingency Reserve
Contingency Reserve Back-Up Power Supply	Dispatchable Reserve	Dispatchable Reserve
Black Start Service	Black-Start Capacity	(Not Traded in WESM)
Energy component and additional capacity of Back-Up Power Supply	Energy Imbalance	Ex-Post Price within Trading Interval
		Spot Energy Purchase beyond Trading Interval
Reactive Power Support	Reactive Power Support	(Not Traded in (WESM)
Customer Load Dropping	(Not Included in filing)	Interruptible Loads in Lieu of Reserve

2.0 Contracting of Ancillary Services

The decision of where to secure the required ancillary services rests on the customer. Customers can enter into a contract under the OATS Rules, participate in the WESM, and/or secure an alternative ancillary services agreement.

2.1 Contracting under the OATS Rules

All Ancillary Services procured outside of WESM shall be contracted by TransCo from qualified Generators and will be recovered through rates and charges from the Generation Customers, Embedded Generation Customers and Load Customers, where applicable.

Ancillary Service Charges shall be paid by Connected Transmission Customers and Embedded Generators, except to the extent that the obligation is relieved in part or in whole by an Alternative Ancillary Service Agreement.

2.2 Participating in the WESM

Ancillary Services which are to be traded in the WESM mostly deal with operating reserve requirements for system operations. In addition, the WESM Rules allow Customers to offer Interruptible Loads as Ancillary Service in lieu of operating reserves, a condition that was not considered in the OATS Rules. This is consistent with Section 3.3.3.5 of the Market Rules.

2.3 Alternative Ancillary Services Agreement

The Alternative Ancillary Services Arrangement must be approved by TransCo by virtue of Section D8 of the OATS Rules.

2.4 Procurement and Cost Recovery (OATS Rules vs. WESM)

AS-CRM is closely related to the manner by which they are procured or contracted. It is in the procurement methods of some Ancillary Services where the distinction between what are traded in the WESM and those procured outside of the WESM (the OATS and WESM regimes) is apparent as discussed in Section 4 of this ASPP.

Table 2.1 shows a comparison of OATS Rules and WESM mode of securing the required ancillary services.

Table 2.1 Ancillary Service Procurement and Cost Recovery

Ancillary Service Types	Procurement	
	WESM	OATS
Load Following and Frequency Regulation = Regulating Reserve	Spot offers	Transition contracts
Spinning Reserve = Contingency Reserve	Spot offers	Transition contracts
Back-Up Power = Dispatchable Reserve	Spot offers	Transition contracts
Black Start Capacity	(Not traded)	Long-term contracts
Energy Imbalance ≈ Ex Ante and Ex Post Pricing	Spot offers	Back-Up Power (energy and additional capacity)
Reactive Power Support	(Not traded)	Long-term contracts
Customer Load Dropping = Interruptible Loads	Spot offers	(Not included)

Table 2.2 shows cost recovery schemes applicable for each type of ancillary service in the OATS and WESM regimes. The columns under cost recovery specify the method of allocating the procurement costs, which could either be imposed to a specific user (i.e., beneficiary of the service), or to all Transmission Customers. When the procurement cost is charged to all Transmission Customers, it is allocated through the use of billing determinant such as system demand or energy consumption. Effectively, this results into the system average rate for that service. The system averaging approach in cost recovery is adopted in both procurement methods under the OATS and WESM regimes. The only difference is mainly in the timeframe of cost allocation (or charging) as will be clarified in the succeeding sections.

Table 2.2 Ancillary Service Procurement and Cost Recovery

Ancillary Service Types	Cost Recovery	
	(WESM) User Specific	(OATS) System Average
Load Following and Frequency Regulation = Regulating Reserve	None	All (capacity)
Spinning Reserve = Contingency Reserve	None	Generator (capacity)
Back-Up Power = Dispatchable Reserve	None	Generator (capacity)
Black Start Capacity	User (energy)	All (capacity)
Energy Imbalance ≈ Ex Ante and Ex Post Pricing	User (energy)	None
Reactive Power Support	Users (reactive energy)	All (capacity)
Customer Load Dropping = Interruptible Loads	None	Generator (capacity)

3.0 Ancillary Services

Ancillary Service Charges shall be paid by Connected Transmission Customers and Embedded Generators, except to the extent that the obligation is relieved in part or in whole by an Alternative Ancillary Service Agreement or via WESM participation.

3.1 Billing Determinant

For the purposes of determining Ancillary Service Charges:

- 3.1.1 The Embedded Generator Billing Determinant for each embedded generating facility shall be the maximum scheduled dispatch in MW of that Generation Customer for the Billing Period for which the Ancillary Services were provided.
- 3.1.2 The Generator Billing Determinant for each Generation Customer shall be the maximum scheduled dispatch in MW of that Generation Customer for the Billing Period for which the Ancillary Services were provided.
- 3.1.3 The Load Billing Determinant for each Load Customer shall be the non-coincident peak demand in kW, measured in fifteen (15) minute intervals, of that Load Customer for the current Billing Period, for which the Ancillary Services were provided.

3.2 Charges

The following formulae on Ancillary Service Charges are taken from Annex VI-Module F of the Proposed Revised OATS Rules (2006 OATS Rules) which TransCo filed to the ERC on 07 July 2006 under ERC Case No. 2006-015 RC.

3.2.1 Regulating Reserve Service

- (a) Regulating Reserve Service Charge (RRC). Prior to the Spot Market Commencement Date, Load Customers, Generation Customers and Embedded Generators shall pay RRC each billing period determined as follows:

$$\text{RRC} = \text{RR Rate} \times \text{ABD}$$

Where:

RR Rate = the Regulating Reserve Rate

ABD = Applicable Billing Determinant which shall be either:

the Load Customer Billing Determinant;
or

the Generator Billing Determinant; or

the Embedded Generator Billing Determinant.

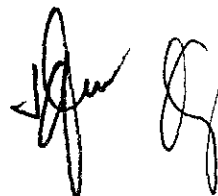
- (b) Regulating Reserve Rate (RR Rate). The RR Rate shall be determined as follows:

$$\text{RR Rate} = \frac{\text{RR Costs}}{\Sigma \text{ABD}}$$

Where:

RR Costs = Expected or contracted cost to the Transmission Provider/System operator for Regulating Reserve Services for the current Regulatory Year, plus any short-fall or less any surplus in aggregate RRC collected in the previous year compared to actual costs in that year, divided by 12.

Σ ABD = The sum of the Billing Determinants for all Transmission Customers including Embedded Generators



- (c) Subsequent to the Spot Market Commencement Date, Transmission Customers shall pay for Regulation Reserves as determined by the WESM Rules, WESM manuals and the Ancillary Services Procurement Plan.

3.2.2 Contingency Reserve Service

- (a) Contingency Reserve Service Charge (CRSC). Prior to the Spot Market Commencement Date, the CRSC payable by the Generation Customer and Embedded Generator in a Billing Period shall be determined as follows:

$$\text{CRSC} = \text{CR Rate} \times \text{GBD}$$

Where:

CR Rate = the Contingency Reserve Rate

GBD = Applicable Generator Billing Determinant which shall be either:

the Generator Billing Determinant; or

the Embedded Generator Billing Determinant

- (b) Contingency Reserve Service Rate (CRSR). The CRSR shall be determined as follows:

$$\text{CR Rate} = \frac{\text{CR Costs}}{\sum \text{GBD}}$$

Where:

CR Costs = Expected or contracted cost to the Transmission Provider/ System Operator for Contingency Reserve Services for the current Regulatory Year, plus any short-fall or less any surplus in aggregate CRSC collected in the previous year compared to actual SR Costs for that year, divided by 12.

\sum GBD = The sum of the Generator and Embedded Generator Billing Determinants for all Generation Customers, including Embedded Generators

- (c) Subsequent to the Spot Market Commencement Date, Transmission Customers shall pay for Contingency Reserves as determined by the WESM Rules, WESM manuals and the Ancillary Services Procurement Plan.

3.2.3 Dispatchable Reserve (Cold Standby) Service

- (a) Dispatchable Reserve (Cold Standby) Service Charge (DRSC). Prior to the Spot Market Commencement Date, the DRSC payable by the Generation Customer and Embedded Generator in a Billing Period shall be determined as follows:

$$\text{DRSC} = \text{DR Rate} \times \text{GBD}$$

Where:

DR Rate = The Dispatchable Reserve (Cold Standby) Service Rate

GBD = Applicable Generator Billing Determinant which shall be either:

the Generator Billing Determinant; or

the Embedded Generator Billing Determinant

- (b) Dispatchable Reserve Service Rate (DRSR). The DRSR shall be determined as follows :

$$\text{DR Rate} = \frac{\text{DR Costs}}{\sum \text{GBD}}$$

Where:

DR Costs = Expected or contracted cost to the Transmission Provider/ System Operator for Dispatchable Reserve (Cold Standby) Services for the current Regulatory Year, plus any short-fall or less any surplus in aggregate DRSC collected in the previous year compared to actual DR Costs in that year, divided by 12.

\sum GBD = The sum of the Generator and Embedded Generator Billing Determinants for all Generation Customers, including Embedded Generators

- (c) Subsequent to the Spot Market Commencement Date, Transmission Customers shall pay for Dispatchable Reserves as determined by the WESM Rules, WESM manuals and the Ancillary Services Procurement Plan.

3.2.4 Black Start Capacity Service

- (a) Black Start Service Charge (BSSC). The BSSC payable by the Load Customer, Generation Customer and Embedded Generator in a Billing Period shall be determined as follows:

$$\text{BSSC} = \text{BSS Rate} \times \text{ABD}$$

Where:

BSS Rate = The Black Start Service Rate

ABD = Applicable Billing Determinant which shall be either:

The Load Customer Billing Determinant; or

the Generator Billing Determinant; or

the Embedded Generator Billing Determinant

- (b) Black Start Service Rate (BSSR). The BSSR shall be determined as follows :

$$\text{BSS Rate} = \frac{\text{BSS Costs}}{\Sigma \text{ABD}}$$

Where:

BSS Costs = Expected or contracted cost to the Transmission Provider/System operator for Black Start Services for the current Regulatory Year, plus any short-fall or less any surplus in aggregate BSSC collected in the previous year compared to the actual BSS Costs in that year, divided by 12.

Σ ABD = The sum of the Billing Determinants for all Transmission Customers, including Embedded Generators



3.2.5 Reactive Power Support Service Charge

- (a) Reactive Power Support Service Charge (RPSSC). The RPSSC payable by the Load Customer in a Billing Period shall be determined as follows:

$$\text{RSSC} = \text{RS Rate} \times \text{LBD}$$

Where:

RS Rate = The Reactive Power Support Service Rate

LBD = Load Customer Billing Determinant

- (b) Reactive Power Support Service Rate (RPSSR). The RPSSR shall be determined as follows:

$$\text{RS Rate} = \frac{\text{RS Costs}}{\sum \text{LBD}}$$

Where:

RS Costs = Expected or contracted cost to the Transmission Provider/ System operator for Reactive Power Support Services for the current Regulatory Year, plus any short-fall or less any surplus in aggregate RSSC collected in the previous year compared to the actual RS Costs in that year, divided by 12.

$\sum \text{LBD}$ = The sum of the Load Billing Determinants for all Load Customers

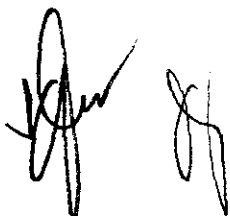
3.2.6 Energy Imbalance

- (a) Energy Imbalance Service Charges

- (i) Imbalance Capacity Charge

The rates and charges for Imbalance Capacity Charge are determined by the following formula:

$$\text{Charge}_{\text{IC}} = \text{Rate}_{\text{Capacity}} \times \sum_d \text{Imbalance}_d^d$$



Where:

- Charge_{IC} - The Imbalance Capacity Charge in Peso payable by the Generation Facility of each Generation Customer and of each Embedded Generator in a Billing Period.
- Rate_{Capacity} - The Back-up Reserve (Cold Standby) Service rate in Peso per kW.
- Imbalance_i^d - The Imbalance Capacity in kW for each Generation Facility of each Generation Customer and of each Embedded Generator "i", recorded in whole kW for each day "d" of the Billing Period. Imbalance Capacity is determined after subtracting the Credited Imbalance from the Maximum Under Generation for the day.

Thus,

$$\text{Imbalance}_i^d = \text{Under Generation}_{\text{Max}} - \text{Credited Imbalance.}$$

Where:

Under Generation_{Max} = Maximum difference between hourly schedule and actual generation for the day.

Credited Imbalance = Under Generation_{Max}, if Under Generation_{Max} is less than % level of AS_{LFFR and SR} X Scheduled Demand_{Max} for the Day

= % level of AS_{LFFR and SR} X Scheduled Demand_{Max} for the Day, if Under Generation_{Max} is greater than % level of AS_{LFFR and SR} X Scheduled Demand_{Max} for the Day

(ii) Energy Imbalance Charge for Net Allowable Shortage

The rates and charges for Energy Imbalance Charge for Net Allowable Shortage are determined by the following formula:

$$\text{Charge}_{\text{EI}} = \text{Rate}_{\text{Energy}} \times \sum_d \text{Imbalance}_i^d$$

Where:

- Charge_{EI} - The Energy Imbalance Charge for Net Allowable Shortage in Peso payable by the Generation Facility of each Generation Customer and of each Embedded Generator in a Billing Period.
- Rate_{Energy} - Average energy rate of Back- up Reserve Providers in Peso per kWh.
- Imbalance_i^d - The Energy Imbalance in kWh for each Generation Facility of each Generation Customer and of each Embedded Generator "i", recorded in whole kWh for each day "d" of the Billing Period. Energy Imbalance for Net Allowable Shortage is net generated amount after subtracting the Allowable Shortage from the Allowable Excess.

Where,

Allowable Shortage = Total Under Generation
within the 1.5 % of the limit

Allowable Excess = Total Over Generation
within 1.5 % of the limit
(Note: Over Generation
above 1.5% limit is not
credited.)

Thus,

If Allowable Excess < Allowable Shortage,
Imbalance_i^d = Allowable Shortage – Allowable
Excess

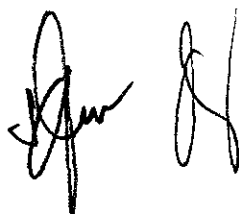
Else,

Imbalance_i^d = 0

(iii) Energy Imbalance Penalty Charge

The rates and charges for Energy Imbalance Penalty Charge are determined by the following formula:

$$\text{Charge}_{EI} = \text{Rate}_{\text{Energy}} \times \text{PIE Factor} \times \sum_d \text{Imbalance}_i^d$$



Where:

- Charge_{EI} - The Energy Imbalance Penalty Charge in Peso payable by the Generation Facility of each Generation Customer and of each Embedded Generator in a Billing Period.
- Rate_{Energy} - Average energy rate of BUR Providers in Peso per kWh.
- PIE Factor - ERC-Approved Penalized Imbalance Energy (PIE) Factor
- Imbalance_i^d - The Energy Imbalance Penalty in kWh for each Generation Facility of each Generation Customer and of each Embedded Generator "i", recorded in whole kWh for each day "d" of the Billing Period. Energy Imbalance Penalty is a generated amount that is 1.5% below the output Scheduled Generation. Energy Imbalance Penalty is determined after subtracting the Allowable Shortage from the Under Generation.

Thus,

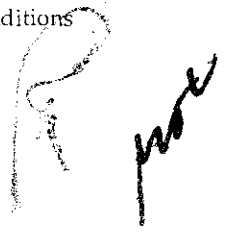
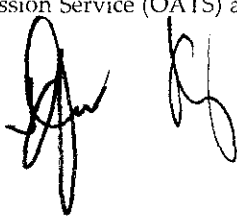
$$\text{Imbalance}_i^d = \text{Under Generation} - \text{Allowable Shortage}$$

3.3 Billing Process

The ERC Order¹ dated February 11, 2004 provides among others that "the Commission is inclined to allow industry participants considerable flexibility to determine the billing process that works best to implement the new billing determinant". The same ERC Order further states that "Customers can be assigned the responsibility for paying the TransCo charges related to the metered demand of Generators, and vice versa. To ensure a smooth implementation, TransCo is given the option to place responsibility for payment of charges on either Generator or the Load Customers who are parties to an existing purchase power agreement, regardless of the location of the metered demand".

Consistent thereto, TransCo adopts a principle, as far as practicable, to place the responsibility of paying the Ancillary Services provided to generators to all benefiting TransCo customers. Simply put, TransCo may recover the costs of Ancillary Services provided to generators from load customers.

¹ ERC Case No. 2002-253 In the Matter of the Application for the Approval of the Proposed Rules, Terms and Conditions for Open Access Transmission Service (OATS) and Proposed Rates, Terms and Conditions of Ancillary Services



Having found the said application sufficient in form and in substance with the required fees having been paid, an Order and Notice of Public hearing, both dated October 3, 2006 were issued setting the case for initial hearing, pre-trial conference, and evidentiary hearing on the following dates:

AREA	DATE, TIME & VENUE	PARTICULARS
LUZON	November 13, 2006 (Monday), at ten o'clock in the morning (10:00 A.M.) at the ERC Hearing Room, 15 th Floor Pacific Center Bldg., San Miguel Avenue, Ortigas Center, Pasig City.	Jurisdictional hearing and Pre-trial conference.
	November 20, 2006 (Monday), at ten o'clock in the morning (10:00 A.M.) at the ERC Hearing Room, 15 th Floor Pacific Center Bldg., San Miguel Avenue, Ortigas Center, Pasig City.	Evidentiary hearing (Reception of evidence and presentation of witnesses)
VISAYAS	November 17, 2006 (Friday), at one-thirty in the afternoon (1:30 P.M.) at the ERC Visayas Field Office (VFO), Machay Building, Gorordo Avenue, Cebu City.	Evidentiary Hearing (Reception of evidence and presentation of witnesses)
MINDANAO	November 28, 2006 (Tuesday) at ten o'clock in the morning (10:00 A.M.) at the ERC Mindanao Field Office (MFO), Mezzanine Floor Mintrade Building, Monteverde cor. Sales St., Davao City.	Evidentiary Hearing (Reception of evidence and presentation of witnesses)

The Office of the Solicitor General (OSG), the Commission on Audit (COA), the National Electrification Administration, 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 hearings.

Likewise, the Offices of the Mayors of Quezon City, Cebu City, Bacolod City, Cagayan de Oro City, and Davao City were furnished with copies of the said Order and the Notice of Public Hearing, for the appropriate posting thereof on their respective bulletin boards.

TransCo was directed to cause the publication of the Notice of Public Hearing, at its 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 scheduled date of the initial hearing. It was also directed to inform the consumers, by any other means available and appropriate, of the filing of the instant application, its reasons therefor, and of the scheduled hearing thereon.

TransCo was also directed to furnish all those making requests therefor with copies of the application and its attachments, subject to reimbursement of reasonable photocopying costs

In the same Order, TransCo was directed to submit to the Commission during the initial hearing, the evidence of the actual posting and publication of the Notice of Public Hearing consisting of certifications issued to that effect, signed by the aforementioned Mayors or their duly authorized representatives, bearing the seals of their offices and the affidavits of the Editors or Business Managers of



the newspapers wherein the said Notice of Public Hearing was published together with the complete copies of the issues of the said newspapers.

On October 11, 2006, the Commission issued an Order provisionally approving the AS-CRM of the ASPP of the TransCo subject to the condition that any ASPP Agreement to be entered by it with the AS Provider shall be filed before the Commission for its approval.

On October 30, 2006, the Commission, thru a letter, requested the appearance and assistance of Mr. Alan V. Alfafara, Executive Director of the Grid Management Committee (GMC) and the Distribution Management Committee (DMC), to act as intervenor during the series of public hearings to be conducted by the Commission.

On November 3, 2006, TransCo filed a "Manifestation with Motion" to change the above-captioned case from Alan T. Ortiz to Mr. Arthur N. Aguilar, in view of the latter's appointment as TransCo's new President and Chief-Operating Officer (COO).

On November 6, 2006, the GMC and DMC thru a letter, manifested their interest to send their representatives to participate as intervenors on the instant application.

On November 8, 2006, TransCo filed a "Manifestation" informing the Commission that it had already complied with the pre-filing requirements. It also filed its "Pre-Trial Brief".

On November 9, 2006, the GMC, DMC, and the National Power Corporation (NPC) filed their respective "Petitions to Intervene".

During the November 13, 2006 initial hearing of this case, TransCo as well as intervenors, NPC, GMC and DMC appeared. Manila Electric Company (MERALCO), Albay Electric Cooperative, Inc (ALECO), Isabela I Electric Cooperative, Inc. (ISELCO I), Consumer Oil Price Watch (COPW), the National Electrification Administration (NEA), and the OSG, appeared as observers.

At the said hearing, TransCo presented its proofs of compliance with the Commission's posting and publication of notice requirements which were duly marked as Exhibits "A" to "W-13", inclusive. Thereafter, TransCo made an expository presentation of its application. In the course of the said presentation, the Commission propounded clarificatory questions.

On even date, TransCo submitted its "Compliance (with Jurisdictional Requirements)".

On November 16, 2006, GMC filed its "Comment".

At the November 17, 2006 hearing of this case at Cebu City, TransCo and intervenors GMC and DMC, as well as Napocor Industrial Consumers Association, Inc. (NICAI) and Visayan Electric Company, Inc (VECO) appeared. At the said hearing, TransCo made an expository presentation of its application for the benefit of the Visayas consumers. Thereafter, it presented its witness, Ms. Cynthia Y. Manrique – its Manager on Tariff Design and Administration



Division, who testified in support of the application. At the termination of the witness' direct examination, the Commission propounded clarificatory questions.

During the November 20, 2006 hearing, TransCo as well as intervenors NPC, GMC and DMC appeared. MERALCO, ALECO, Trans-Asia Power Generation Corporation (TAPGC), KEPCO Philippines Power Corporation (KEPHILCO), and Nueva Ecija II Electric Cooperative, Inc. appeared as observers. During the said hearing, TransCo presented the same witness, Ms. Manrique for cross-examination. NPC then conducted its cross-examination on the said witness.

On even date, TAPGC, submitted, thru a letter, its comment.

On November 22, 2006, TransCo filed its "Additional Compliance (with Jurisdictional Requirements)", submitting therewith the certification of posting issued by the City Mayor of Cebu.

On November 24, 2006, GMC submitted its "Comment/Suggestion", particularly on the "Causers Pay" provision of the AS-CRM –ASPP application of TransCo.

At the November 28, 2006 hearing of this case in Davao City, TransCo and intervenors NPC, DMC and GMC appeared. Several Distribution Utilities such as Davao Light and Power Company (DLPC), Davao del Norte Electric Cooperative, Inc (DANECO), Davao Oriental Electric Cooperative, Inc. (DORECO), Cotabato Electric Cooperative, Inc. (COTELCO), South Cotabato Electric Cooperative, Inc. (SOCOTECO), as well as Mindanao Energy System

(MINERGY) appeared as observers. At the said hearing, TransCo made an expository presentation of its application for the Mindanao consumers. At the termination of the said presentation, intervenors and observers raised their respective issues and concerns relative to the said application.

On same date, TransCo submitted its "Compliance with Manifestation" and "Reply to Comments (on the Ancillary Services-Cost Recovery Mechanism)". Likewise, MINERGY submitted its "Comments".

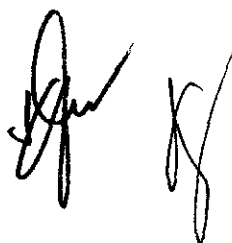
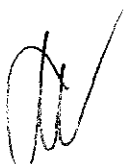
On November 29, 2006, VECO submitted, thru a letter, its comment.

On December 15, 2006, NPC filed its "Rejoinder to TransCo's positions (reply) on AS-CRM" and "Motion to Admit Rejoinder".

On December 21, 2006, GMC submitted its "Position" on the various comments on AS-CRM public consultation held at Cebu City and Davao City.

On December 22, 2006, TransCo filed its "Compliance with Manifestation" incorporating therewith its reply to MINERGY and GMC and other documents.

On December 29, 2006, TransCo filed its "Formal Offer of Evidence" which is hereby admitted for being relevant and material in the resolution of the instant application.



DISCUSSION

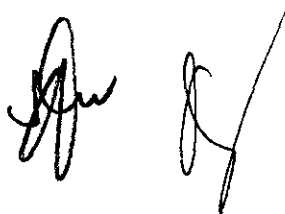
I. SALIENT FEATURES OF ANCILLARY SERVICES – COST RECOVERY MECHANISM (AS - CRM)

The AS-CRM is a mechanism designed to allow TransCo to recover the cost of ancillary services it arranged with or procured from the qualified ancillary services provider/s for the system requirement from a particular user or beneficiary or beneficiaries.

The AS-CRM likewise serves as a complement to the ASPP and is intended to be revenue neutral, hence, there is no gain or loss on the part of TransCo from all generation-related ancillary services transactions.

Further, the AS-CRM is designed to ensure that:

- 1) TransCo will not incur any losses and financial cost in securing the required ancillary services to the system;
- 2) TransCo will allow the computation of any over-or-under-recovery on all ancillary services transactions;
- 3) TransCo will keep intact its approved revenue; and
- 4) TransCo will include recovery mechanisms for the following ancillary services:
 - a) Load following and frequency regulation or regulating reserve intended to be billed and charged to load and generator customers;
 - b) Spinning Reserve or Contingency Reserve intended to be billed and charged to generator customers;
 - c) Back-up Power or dispatchable reserve intended to be billed and charged to generator customers;
 - d) Reactive Power Support intended to be billed to load customers; and
 - e) Black-Start Capacity Service intended to be billed and charged to load and generator customers.

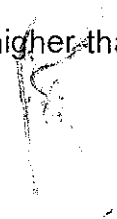


II. IMPORTANCE OF THE ANCILLARY SERVICES – COST RECOVERY MECHANISM

TransCo, as the System Operator, under the Grid Code, is mandated to ensure and maintain the power quality, reliability and security of the Philippine Grid. However, with the ever increasing demand for power supply and requirements of AS and the limited supply of electricity from NPC, TransCo realized the need to procure AS from other AS providers.

In the Visayas Region alone, particularly the area of Cebu City, the Commission finds that there is an insufficient supply of electricity. While the other service providers, such as the East Asia Power Corporation (EAPC) located in Mactan City, have signified its interest to fill-up the shortage of supply of electricity of Cebu City, they are apprehensive to enter into an AS of replacement power contract with TransCo or any other entity due to the higher costs of operation in providing the needed AS and the possibility not being properly compensated. On the other hand, TransCo is hesitant to enter into this type of agreement in the absence of any recovery mechanism. Thus, there is a need to put in place the AS-CRM in order to address the insufficient supply of electricity.

Records of the Commission show that NPC is the current and dominant AS provider in the whole of Philippine Grid. Given the ever increasing requirements of AS for the Philippine Grid and the limited supply of electricity by the NPC, there is, therefore, an urgent need to procure AS from the other accredited AS providers in order to address the shortage of supply of electricity and maintain the integrity of the transmission grid. However, the other prospective service providers are not motivated from participating in the provision of ancillary services because the actual cost involved is higher than the present



approved AS rate (as contained in the Commission's Decision in NPC's unbundling application in ERC Case No. 2001-901 dated September 20, 2002, with 2002 as the test year). The present and existing rate is said to be lower due to the fact that at the time it was established, the rates and the existing billing recovery mechanism were designed based on the 2002 operation and maintenance costs of NPC Power Plants.

Thus, with the approval of the AS-CRM, TransCo shall have the option to source its present AS from other service providers other than NPC because the mechanism guarantees TransCo's full recovery of costs of procuring the needed AS from the other providers.

MAJOR ISSUES RAISED BY THE PARTIES OF THE CASE:

1. Charging and Recovery of Ancillary Services / Billing Process (Section 3.3):

Comments of Mindanao Energy System (Minergy):

"TransCo proposed to recover the costs of providing Ancillary Services (AS) to different type of customers depending on the type of AS. Some type of ancillary services like the Contingency and Dispatchable (or Back Up) Reserves are proposed to be recovered from Generator Customers only.

Regardless of where the AS will be charged by TransCo, these charges will ultimately be paid by the load customers or end-users. What is important here is that the AS charges that TransCo charged to the Generation Customers should be unbundled and segregated from the regular generation charges when the Generation Customer recovers these charges from the load customers or end users".

Comments of the National Power Corporation (NPC):

"The proposed Billing Process seemed inconsistent with the proposed formulas under Section 2 which talks about recovery of costs from either the Load Customers or the generators or both. The inclusion of the statement, "Simply put, TransCo may recover the costs of Ancillary Services provided to generator from load customers", tends to defeat the objectivity of the AS-CRM and may result to cross-subsidization of the AS costs"



TransCo's Position:

"TransCo notes that the Honorable Commission leans towards the imposition of all charges to the load customers. Thus, this particular clause. However, the intention of the AS-CRM is to bill both generators and load customers, as the formulae provide. TransCo believes that the cost of AS should be shared by benefiting customers, load and generators as the case maybe".

2. Billing Determinants (Section 1.2.c):

Comments of Trans Asia Power Generation Corporation

"One of the principles in the design of the AS-CRM (Section 1.2.c) states that "...the timeframe for system averaging should be as close as practicable (i.e. coincident) to the time services are being provided... For example, the cost allocation of reserve should be based on the hourly schedules instead of using monthly peak demands".

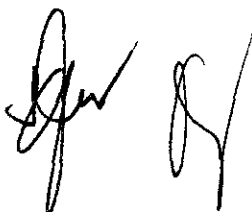
However, prior to Spot Market Commencement Date, the billing determinant (Embedded Generator, Generator, Load) for cost recovery is still computed as the highest MW occurrence for the billing period. For peaking generation that operates only four (4) hours a day will be paying up to six times more than a baseload generator. If the reserve cost is about P0.50/kWh for a baseload generator, then the cost for the peaking generator is about P3.00/kWh.

A generator, especially those for peaking, should pay for reserve costs only when it is dispatched, consistent with the "Causers Pay" principle mentioned in Section 1.2.b. A generator when "off-line" is no longer a cause for having regulating, or contingency, or dispatchable reserves.

Although the cost of reserve is based on capacity, cost recovery can be based on energy, even prior to Spot Market Commencement Date".

TransCo's Position:

"The cost allocations for Generators are based on the daily maximum schedule and not on the maximum MW occurrence for the billing period. The rates for generators will be in pesos/kW/day. In this way, generators that are not scheduled on some days of the billing months will not be billed for A/S when they are "off-line" for those particular days. The ideal cost allocation would be on pesos/kW/hr, however TransCo's existing Billing System is not capable of computing for hourly rates unlike that of the WESM".



ANALYSIS

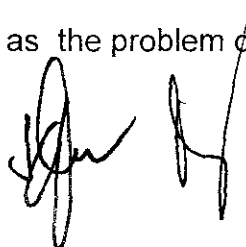
1. On the Issue of Charging and Recovery of Ancillary Service:

As stated in the Application, the proposed "Causers Pay" Principle intends that if the necessity of a certain Ancillary Service can be attributed to a particular user or beneficiary, the cost of that service should be charged accordingly to that particular user. Otherwise, the cost should be allocated in proportion to the level of transaction in the grid.

The Commission believes that the "Causers Pay" principle may be immaterial inasmuch as the Generator Customers can always impute the AS charges as part of their operation and maintenance costs which will eventually be charged to their Load Customers. Hence, allocating 100% of the cost of AS to Load Customers would be reasonable considering that it will lessen the layers of transaction among the stakeholders and also reduces the cost of operation of TransCo as well as the Generation Customers. However, the proposed allocation (i.e.100% to Load Customers) shall be adopted in the computation of cost recovery only and until such time that such AS is already traded in the WESM.

2. On the issue of Billing Determinants

The issue pertaining to the Billing Determinant (BD) is valid concern which needs to be addressed. The Commission believes that TransCo should be capable of recording the hourly peak occurrence on each Generation Customer in view of its current function as Metering Service Provider under WESM. WESM, as stated by TransCo, has the capability of computing for an hourly rate. However, inasmuch as the problem of TransCo is in its existing Billing System





(i.e. incapable of computing an hourly rates (PhP/kW/hr)), which is different from the system in WESM, the billing determinant as proposed in the AS-CRM shall be applied only until a new BD or until a new scheme shall have been proposed for the Commission's approval not later than the end of 2009.

The Commission, after thorough evaluation and consideration of all the documents and comments submitted by various industry players, recognizes the importance and the urgency to establish the AS-CRM of TransCo. Considering the limited supply from NPC, the AS-CRM will address the shortage and the ever increasing demand for power supply and the requirement of AS. With the AS-CRM in place to complement the ASPP, TransCo will be able to recover the cost of ancillary services it arranged with the qualified ancillary services provider/s for the system requirement from a particular users or beneficiary or beneficiaries.

WHEREFORE, the foregoing premises considered, the application for approval of the Ancillary Services – Cost Recovery Mechanism (AS-CRM) of the Ancillary Services Procurement Plan (ASPP) filed by the National Transmission Corporation (TransCo) with prayer for provisional authority, is hereby **APPROVED** subject to the following conditions:

1. The following changes should be incorporated on the proposed AS-CRM of the ASPP:
 - a. The cost of procuring the Ancillary Services (AS) under the ASPP shall be recovered 100% from the load customers but only until such time that such AS is already traded in the Wholesale Electricity Market (WESM);



- b. The use of the Billing Determinant (BD) as proposed in the AS-CRM should continue until a new BD has been established and TransCo's recommendations have been considered by the Commission starting 2010;
2. All contracts for the procurement of AS entered into by and between TransCo and AS providers shall be submitted on or before December 28, 2007; and
3. The implementation of the AS-CRM shall be made effective starting March 26, 2008 after incorporating therein the proposed changes particularly on the allocation of cost.

Further, TransCo is hereby directed to:

- a. Make amendments in the terminology used for consistency with the 2006 Revised OATS Rules;
- b. Include provision for annual post-verification of the Commission of the contracted vis-a-vis actual recovered AS costs; and
- c. Provide the requirement for the Commission's approval prior to the implementation of any AS Contract Agreement.

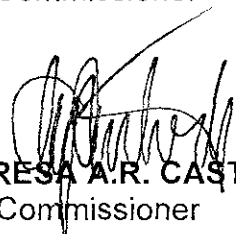
SO ORDERED.

Pasig City, October 3, 2007.


RODOLFO B. ALBANO, JR.
Chairman


RAUF A. TAN
Commissioner


ALEJANDRO Z. BARIN
Commissioner


MARIA TERESA A.R. CASTAÑEDA
Commissioner


JOSE C. REYES
Commissioner

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Cebu City

