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HON. ZENAIDA CRUZ-DUCUT
Chairperson, Energy Regulatory Commission
16th Floor Pacific Center Bldg.
San Miguel Avenue, Pasig City

Subject: APPRAISAL INCREASE

Dear Chairperson Ducut,

Greetings!

This pertains to the **appraisal increase** resulting from MERALCO's asset revaluation we believe should be correctly treated as consumers' equity and not as owners' equity.

Section 43(i) of the Electric Power Industry Reform Act (EPIRA) provides that the Energy Regulatory Commission (ERC) may allow Transco or any distribution utility (DU) to revalue its assets not more than once every three (3) years by an independent appraisal company for purposes of determining the rate base. As an outcome of this asset revaluation, the value of a distribution utility's rate base or the stockholders' total investments in assets is substantially increased albeit without new and actual investment on the part of the utility owners. This we find highly questionable and irregular.

It is our understanding that the Commission allows this appraisal increase in the value of the utility's asset base for two reasons. The first is to allow Transco or any DU to build up a fund for the replacement of these assets for the upgrading and expansion of their respective electrical system through a cost recovery scheme called "depreciation expense" and for proper accounting and recording of the value of the utility assets for the guidance of the utility owners in replacing its worn-out assets.

While we agree with these twin objectives, we would like to manifest our opposition to the current practice of crediting to the utility owners this incremental increase in the value of the assets resulting from the asset revaluation for the following reasons:

1. It is unjust because there was no new and actual capital infusion on the part of the utility owners.
2. It unduly burdens the consumers because this asset revaluation increases the value of the asset base upon which the percentage on the return on rate base (RORB) is applied. This increase is passed-on to the consumers thus, making the rates per kilowatt-hour unnecessarily rise.
3. The utility assets were generally acquired through loans and not through owners' capitalization. The amount of loans used in acquiring new assets are also recovered through the "depreciation expense" mechanism which is passed-on to the consumers on a per kilowatt-hour basis, meaning, it is the consumer who provides for the replacement fund.
4. The interests on loans is, likewise, recovered through the ERC-approved RORB (return on rate base). In its RORB computation, ERC granted the Meralco loans an 11.34% return in May 2003 and also on a per kilowatt-hour basis.
5. Even the loans affected by fluctuations in currency exchange rates are addressed through the ERC-approved Currency Rate Exchange Mechanism (CERA) which again is passed-on to the consumers.

Therefore, when Transco or any DU treats the amount of this appraisal increase or asset revaluation as their fresh capital infusion in their book of accounts, we believe consumers are being deceived and deprived of their individual capital contribution by way of their patronage through this mechanism of asset revaluation.

In the 1987 Annual Report of Meralco, this appraisal increase had an initial or beginning balance of P3.33-billion and this rose to P20.292-billion in 2007. This is the unrealized portion of appraisal increase (also known as unrealized gain) that was credited to Common Stock as additional investments.

However, the figures in the table below sourced from Meralco's annual reports shows the summary of all the **realized appraisal increase** through depreciation which was credited to retained earnings as realized income.

Year	Realized Appraisal through Yearly Depreciation (credited to Retained Earnings)
1987	380,244,000.00
1988	385,300,000.00
1989	406,832,000.00
1990	457,996,000.00
1991	719,992,000.00
1992	776,484,000.00
1993	810,236,000.00

1994	818,314,000.00
1995	711,071,000.00
1996	999,137,000.00
1997	1,128,905,000.00
1998	1,486,043,000.00
1999	1,631,184,000.00
2000	1,115,954,000.00
2001	1,156,551,000.00
2002	993,000,000.00
2003	704,000,000.00
2004	637,000,000.00
2005	510,000,000.00
2006	424,000,000.00
2007	407,000,000.00
TOTAL	16,659,243,000.00

In view of this, we implore the Honorable Commission to direct Transco, Meralco and other concerned DUs to recognize the amount of realized appraisal increase based on asset revaluation as "Consumers' Equity" instead of being made part of the retained earnings. Failure to do so would constitute "unjust enrichment" on their part.

We fervently hope the Commission would support our clamor for the recognition of this amount of appraisal increase as consumers' equity.

Very truly yours,

PETE L. ILAGAN
President