

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

IN THE MATTER OF THE
APPLICATION FOR
APPROVAL AND RECOVERY
FROM END-USERS OF THE
PRICE ADJUSTMENT
UNDER THE ERC-
APPROVED PSA BETWEEN
MANILA ELECTRIC
COMPANY (MERALCO) AND
THERMA LUZON, INC.
(TLI), BROUGHT ABOUT BY
THE IMPOSITION OF
INCREASED EXCISE TAXES
ON COAL UNDER THE "TAX
REFORM FOR
ACCELERATION AND
INCLUSION" LAW, WITH
PRAYER FOR PROVISIONAL
AUTHORITY,

ERC CASE NO. 2018-82 RC

MANILA ELECTRIC
COMPANY (MERALCO) AND
THERMA LUZON, INC.
(TLI),

Applicant.

X ----- X

DOCKETED
Date: AUG 09 2018
By: M

NOTICE OF PUBLIC HEARING

TO ALL INTERESTED PARTIES:

Notice is hereby given that on 19 July 2018, Manila Electric Company (MERALCO) and Therma Luzon, Inc. (TLI) filed a *Joint Application* for the approval and recovery from end-users of the price adjustment under their approved Power Supply Agreement (PSA) brought about by the imposition of increased excise taxes on coal under the Tax Reform for Acceleration and Inclusion (TRAIN) Law, with prayer for provisional authority.

In the said *Joint Application*, MERALCO and TLI alleged the following:

1. MERALCO is a private corporation existing under the laws of the Republic of the Philippines, with principal office located at Lopez Building, Meralco Center, Ortigas Avenue, Pasig City. It may be served with notices and other processes of this Honorable Commission at its principal office address or through its counsel at the address indicated herein.

2. MERALCO has a legislative franchise to operate and maintain a distribution system in the cities/municipalities of Metro Manila, Bulacan, Cavite and Rizal and certain cities/municipalities/barangays in Batangas, Laguna, Quezon and Pampanga, pursuant to Republic Act No. 9209, and is authorized to charge all its customers for their electric consumption at the rates approved by the Honorable Commission.

3. TLI is a corporation organized and existing under and by virtue of Philippines laws with office address at NAC Tower, 32nd Street, Bonifacio Global City, Taguig. It is the Independent Power Producer Administrator that manages and controls the contracted capacity of the 700 MW (net) coal-fired power generating facility in Pagbilao, Quezon. It may be served with pleadings, notices, orders, and other processes of the Honorable Commission through undersigned counsel.

4. On 09 March 2012, applicant MERALCO filed an application with the Honorable Commission for the approval of its Power Supply Agreement (PSA) dated 29 February 2012 with TLI for the purchase of 350 MW capacity of the Pagbilao Power Plant (Unit 1), a coal-fired power generating facility in Pagbilao, Quezon. The case was docketed as ERC Case No. 2012-035 RC.

4.1. The PSA is originally for a term of seven (7) years following fulfilment of certain conditions under the PSA, including approval of the Honorable Commission.

5. In its Decision dated 17 December 2012 in ERC Case No. 2012-035 RC, the Honorable Commission approved with modification said PSA, thus:

“WHEREFORE, the foregoing premises considered, the application for the approval of the Power Supply Agreement (PSA) between Manila Electric Company (MERALCO) and Therma Luzon, Inc. (TLI) is hereby **APPROVED with MODIFICATION.**

Accordingly, the approved rates are as follows: xxx.”

6. With the approval of the Honorable Commission, MERALCO’s PSA with TLI is set to expire on 26 December 2019.

6.1. It should be noted, however, that on 6 May 2016, MERALCO filed a *Manifestation with Motion dated 05 May 2016*, praying for the Honorable Commission’s confirmation that the **extension of the PSA from 26 December 2019 until 25 December 2022 (“Extended Term”)**, pursuant to the Supplemental Agreement executed

between the parties, is consistent with and valid under Section 2.2.3 of the ERC-approved PSA.

6.2. Said Manifestation with Motion is still pending confirmation by the Honorable Commission.

7. The instant Joint Application seeks the approval by the Honorable Commission of the adjustment of the Price under the ERC-approved PSA, and the corresponding recovery of such adjustment from MERALCO's customers, brought about by the imposition of the increased excise taxes on coal **under Republic Act No. 10963**, otherwise known as the **"Tax Reform for Acceleration and Inclusion (TRAIN),"** or TRAIN Law.

Increased excise taxes on coal under the TRAIN Law

8. The TRAIN Law became effective on 01 January 2018.

8.1. Among other things, the TRAIN Law increased the excise tax on coal from PhP10.00/metric ton to PhP 50.00/metric ton, effective January 1, 2018. This tax is to increase year on year, up to PhP 150.00/metric ton for coal, effective January 1, 2020, thus:

"SEC. 48. Section 151 of the NIRC, as amended, is hereby further amended to read as follows:

"SEC. 151. *Mineral Products.* –

"(A) Rates of Tax. – There shall be levied, assessed and collected on minerals, mineral products and quarry resources, excise tax as follows:

"(1) On domestic or imported coal and coke, notwithstanding any incentives granted in any law or special law:

"Effective January 1, 2018, Fifty pesos (P50.00) per metric ton;

"Effective January 1, 2019, One hundred pesos (P100.00) per metric ton; and

"Effective January 1, 2020, One hundred fifty pesos (P150.00) per metric ton; xxx" (Emphases and underscoring supplied.)

***Price structure under PSA
incorporates excise tax on coal***

9. Under Appendix D of the PSA, **excise tax** is included as part of the Monthly Fuel Payment, thus:

"xxx

APPENDIX D
CALCULATION OF PAYMENT

xxx

Energy Payment

Component C – Monthly Fuel Payment

The Monthly Fuel Payment (MFP) shall be based on the following formula:

$$MFP_{USD} = MFCC_{USD} + MFTC_{USD} + AFC_{USD} \quad (\text{in USD})^1$$

xxx

a) Monthly Fuel Commodity Cost (MFCC_{USD})

$$MFCC_{USD} = (\sum BCQ - RP) * HR * DF * \frac{1}{1,000,000} * FCC_0 * \left(\frac{FI_i}{FI_0}\right) (\text{in USD})$$

xxx

Where:

FCC₀ = base fuel commodity cost, **including excise tax**, as indicated in Schedule 1, expressed on a HHV and gross-as-received basis, and expressed in USD/MBtu.

xxx”

***Increased excise tax on coal as
“Charges due to Change in Law”
under the PSA***

10. Sections 10.2(c) and 16.6.5 of the PSA provide that should there be any **increase** in existing charges, fees, **taxes**, duties assessments, or other similar amounts, a party to the PSA may claim the same as a Charge due to Change in Law. Thereupon, the parties shall enter into good faith negotiations to agree on a satisfactory solution, including an adjustment of the Price, which adjustment shall be submitted to the Honorable Commission for approval. Thus:

“10.2 Charges Due to Change in Law

(a) xxx new charges, fees, taxes, duties, assessments or other similar amounts (“**New Charges**”), or any increase in existing charges, fees, taxes, duties, assessments or other similar amounts (“**Increased Charges**”) xxx.

xxx

(c) If as a result of a Change in Law, Power Supplier becomes liable to pay New Charges or Increased Charges with respect to this Agreement, xxx Power

Supplier shall send a notice to Meralco of the occurrence of such Change in Law ("**Notice of Change in Law**") and **Meralco shall file the necessary application with the ERC for adjustment of the Price ("Application for Price Adjustment") within thirty (30) Days from receipt of the Notice of Change in Law**; provided that Meralco shall not be liable to pay any adjustment in the Price from the time the Change in Law becomes effective until the ERC approves the Application for Price Adjustment ("**Interim Period**"); xxx

In the event that,

- (i) Meralco is unable to file an Application for Price Adjustment within thirty (30) Days from receipt of Notice of Change in Law, or
- (ii) The ERC denies, in whole or in part, the Application for Price Adjustment, or
- (iii) If no order is issued granting the Application for Price Adjustment within sixteen (16) months from Meralco's receipt of the Notice of Change in Law, or
- (iv) the total amount of unreimbursed New or Increased Charges, Disallowed Pass-Through Amounts that Power Supplier is unable to collect from Meralco, and the Refundable Amounts actually refunded by Power Supplier, accumulated during all Interim Periods for all Change in Law events occurring for the entire Term ("**Unreimbursed New or Increased Charges and Refundable Amounts**") exceeds the equivalent of two percent (2%) of the Capacity Payments for the current Contract Year ("**Level 1 Threshold**").

the Parties shall enter into good faith negotiations to agree on a satisfactory solution regarding the amendment of this Agreement to restore each Party's commercial position prior to such Change in Law, including an adjustment of the Price. If the Parties fail to reach a mutually satisfactory resolution within sixty (60) Days from the commencement of negotiations, the provisions of Section (b) shall apply.

xxx

16.6.5 Termination in the Event of Change in Law

(a) xxx

(b) **If a Change in Law occurs under the circumstances and having the consequences described in Section 10.2(b) and Section 10.2(c) or amounts paid under Section 12.1.3 exceed the Level 2 Threshold, and the Parties have failed to agree on a solution satisfactory to each of the Parties,**

then the Party that is adversely affected by the Change in Law may terminate this Agreement upon sixty (60) Days prior written notice to the other Party." (Emphases supplied.)

TLI's claim of Change in Law pursuant to Sections 10.2(c) and 16.6.5 of the PSA

11. In its letter dated 26 January 2018, TLI notified MERALCO of the occurrence of a Change in Law pursuant to Sections 10.2(c) and 16.6.5 of the PSA, relative to the imposition of increased excise taxes on coal under the TRAIN Law. *Attached as Annex "A" is the letter dated 26 January 2018 of TLI to MERALCO.*

12. After a series of meetings between MERALCO and TLI and TLI's provision of its calculation showing depletion of coal inventory and onset of use of new coal for the February 2018 supply month (March 2018 Bill), the parties agreed to file the necessary Application for Price Adjustment with the Honorable Commission. **Hence, the instant Joint Application.**

13. Applicants propose the following formula to adjust the monthly payments under the PSA to recover the costs associated with the increased excise tax on coal due to the TRAIN Law:

Monthly Payment for Coal Additional Excise Tax (MPCAET)

MPCAET = V x AET_y

where:

V = Volume of coal utilized during the relevant Billing period, in MT as calculated in the formula below:

$$V = \frac{HR \cdot DF \cdot (\sum BCQ - RP)}{CHV \cdot 1,000} \qquad \text{(in MT)}$$

- HR = applicable Heat Rate, in btu/kwh
- DF = applicable Degradation Factor (no unit)
- ΣBCQ = Bilateral Contract Quantities, in kwh
- RP = Replacement Power, in kwh
- CHV = Coal Heating Value, in btu/kg

AET_y = Additional Excise Tax for year y, in PhP/MT, as follows:

Applicable Year	[y]	Additional Excise Tax in PhP/MT [AET _y]
2018	1	40
2019	2	90
2020 and onward	3	140

**Impact of the increased excise tax
on coal on the Price under the PSA**

14. MERALCO conducted a simulation of the impact of the increased excise tax on coal on the Price under the PSA, under given assumptions.

14.1. Notwithstanding the pendency of the Honorable Commission's confirmation of the Extended Term of the PSA, i.e., from 26 December 2019 until 25 December 2022, MERALCO deems it prudent to include in its simulation such Extended Term in order to provide the Honorable Commission a more comprehensive impact of the increased excise tax on coal on the Price under the PSA.

**Impact of Additional Excise Tax on TLI's Generation Cost and
MERALCO's Captive Generation Cost**

		Unit	2018	2019	2020	2021	2022
(a)	Additional Excise Tax	Php/MT	40	90	140	140	140
(b)	Heat Rate (at 90% LF)	BTU/kWh	10,016	10,016	10,016	10,016	10,016
(c)	Degradation Factor		1.0182	1.0284	1.0387	1.0491	1.0491
(d)	Base Coal Heating Value	BTU/kg	21,826	21,826	21,826	21,826	21,826
(e)	Increase in Generation Cost of TLI	Php/kWh	0.0187	0.0425	0.0667	0.0674	0.0674
= (a x b x c) / (d * 1000)							
(f)	Share of TLI in Meralco Captive Energy (using Feb 2018 data)		7.0%	7.0%	7.0%	7.0%	7.0%
(g)	Increase in Captive Generation Cost of MERALCO	Php/kWh	0.0013	0.0030	0.0047	0.0047	0.0047
= e * f							

14.2. As can be gleaned from the foregoing simulation, under given assumptions, the resulting increase in **TLI's generation cost** due to the new coal tax rates, for the years 2018 to 2020, are as follows:

Year	Increase in TLI Generation Cost (in Php)
2018	0.0187/kWh
2019	0.0425/kWh
2020	0.0667/kWh ¹

14.3. In addition, as seen from the foregoing simulation, the increase in **MERALCO's captive generation cost** for the years 2018 to 2020 would be:

Year	Increase in Meralco Captive Generation Cost (in Php)
2018	0.0013/kWh
2019	0.0030/kWh
2020	0.0047/kWh ²

15. It bears emphasis that in its Decision dated 17 December 2012, the Honorable Commission recognized the pass-through nature of fuel costs, which include the excise tax on coal, thus³:

¹ Increase in TLI's Generation Cost (in Php) in year 2021 until expiration of Extended Term on 25 December 2022 is 0.0674/kWh. until expiration of Extended Term on 25 December 2022.

² Increase in MERALCO's Captive Generation Cost (in Php) until expiration of Extended Term on 25 December 2022.

³ Pp. 20-21, Decision.

“VIII. EVALUATION

xxx

The Energy Fees, Variable O&M Charges were verified to be a pass-through cost representing the charges that the IPPAs are required to pay to PSALM under the IPPA Agreements.

xxx

The Fuel Cost was, likewise, found to be a pass-through charge, subject to the guaranteed heat rates as provided under their respective Agreements.

xxx

X. COMPARISON BETWEEN TLI’S PROPOSED RATE AND THE COMMISSION’S APPROVED RATE

xxx

The Fuel Costs are also adopted since they represent the recovery of costs of fuel used to generate electricity subject to the guaranteed heat rates under the IPPA Agreements. xxx”

ALLEGATIONS IN SUPPORT OF THE PRAYER FOR PROVISIONAL AUTHORITY

16. Applicants replead all the foregoing statements.

17. It is respectfully reiterated that the increase in the excise tax is a mandatory imposition of the TRAIN Law. Thus, such increase would have to be included in the Monthly Fees chargeable to and payable by MERALCO and consequently recoverable from MERALCO’s customers.

18. Considering that the TRAIN Law is in effect, it is necessary that the PSA immediately reflect the effect of the new excise tax rates. Thus, the request for the issuance of a Provisional Authority.

19. In support of this Joint Application and the prayer for issuance of a Provisional Authority, the Judicial Affidavits of **MR. RONALDO S. RAMOS**, Vice President for Corporate Services of Aboitiz Power Company’s Coal Business Unit and **MR. CIPRINILO C. MENESES**, Head of MERALCO’s Energy Sourcing Office, are attached as ANNEXES “B” and “C”, respectively.

PRAYER

WHEREFORE, premises considered, Applicants MERALCO and TLI respectfully pray that the Honorable Commission:

1. Issue an **Order GRANTING PROVISIONAL AUTHORITY** to implement the Additional Coal Excise Tax Monthly Payment to adjust the monthly payments under the PSA, and the

corresponding recovery of such adjustment from MERALCO's customers, beginning from effectivity of the imposition of the increased excise taxes on coal under the TRAIN Law; and

2. After hearing on the merits, a **DECISION BE RENDERED APPROVING** the implementation of the Additional Coal Excise Tax Monthly Payment to adjust the monthly payments under the PSA, and the corresponding recovery of such adjustment from MERALCO's customers, beginning from effectivity of the imposition of the increased excise taxes on coal under the TRAIN Law.

Other relief just and equitable under the circumstances are likewise prayed for.

Pasig City, 20 June 2018

The Commission has set the *Joint Application* for determination of compliance with the jurisdictional requirements, expository presentation, Pre-trial Conference, and presentation of evidence on **18 September 2018 (Tuesday) at two o'clock in the afternoon (2:00 P.M.), at 15th Floor, ERC Hearing Room, Pacific Center Building, San Miguel Avenue, Pasig City.**

All persons who have an interest in the subject matter of the instant case may become a party by filing with the Commission a verified Petition to Intervene at least five (5) days prior to the initial hearing and subject to the requirements under Rule 9 of the 2006 ERC Rules of Practice and Procedure, indicating therein the docket number and title of the case and stating the following:

- 1) The petitioner's name and address;
- 2) The nature of petitioner's interest in the subject matter of the proceeding and the way and manner in which such interest is affected by the issues involved in the proceeding; and
- 3) A statement of the relief desired.

All other persons who may want their views known to the Commission with respect to the subject matter of the case may file their Opposition or Comment thereon at any stage of the proceeding before Applicants rest their case, subject to the requirements under Rule 9 of the 2006 ERC Rules of Practice and Procedure. No particular form of Opposition or Comment is required, but the document, letter, or writing should contain the following:

- 1) The name and address of such person;
- 2) A concise statement of the Opposition or Comment; and
- 3) The grounds relied upon.

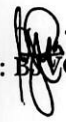
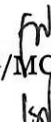
All such persons who wish to have a copy of the *Joint Application* may request from Applicants that they be furnished with the same, prior to the date of the initial hearing. Applicants are hereby directed to furnish all those making such request with copies of the *Joint Application* and its attachments, subject to the reimbursement of reasonable photocopying costs. Any such person may likewise examine the *Joint Application* and other pertinent records filed with the Commission during the standard office hours.

Pasig City, 2 August 2018.

FOR AND BY AUTHORITY
OF THE COMMISSION:


AGNES VST DEVANADERA
Chairman and CEO

W

LS:   
BVG/MCC/BSA/APV

