

GUIDELINES TO THE SALE AND TRANSFER OF THE TRANSCO'S SUBTRANSMISSION ASSETS AND THE FRANCHISING OF QUALIFIED CONSORTIUMS

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Pursuant to Sections 7 and 8 of Republic Act No. 9136 or the Act and Rule 6 of the Implementing Rules and Regulations (IRR) of the Act, the Energy Regulatory Commission (ERC) hereby adopts and promulgates these guidelines to:

- a) Set the standards to distinguish the National Transmission Corporation's (TRANSCO's) Transmission Assets from its Subtransmission Assets;
- b) Establish an approval process prior to the final sale and transfer of transmission Assets to distribution utilities; and
- c) Govern the granting of franchise to the consortium or juridical entity to operate the Subtransmission Assets.

Article I

General Provisions

These Guidelines shall have the following objectives:

- a. To ensure the continued quality, reliability, security and affordability of electric service to end users;
- b. To ensure the transparent and reasonable prices of electric service in a regime of free and fair competition and to achieve greater operational and economic efficiency;
- c. To enhance the inflow of private capital and broaden the ownership base of Subtransmission Assets; and
- d. To provide for the orderly and transparent sale and transfer of Subtransmission Assets of the TRANSCO or its Buyer or Concessionaire to Qualified Distribution Utilities and Qualified Consortiums.

Article II

Scope and Definition of Terms

SECTION 1. Scope - These Guidelines shall apply to:

- a) TRANSCO;
- b) Buyer or Concessionaire of the TRANSCO; and
- c) Any Qualified Distribution Utility or Qualified Consortium that intend to or shall acquire and assume responsibility for operating, maintaining, upgrading, and expanding a Subtransmission Asset of the TRANSCO or its Buyer or Concessionaire.

These Guidelines shall not apply to the assets owned by entities other than the TRANSCO or its Buyer or Concessionaires.

SECTION 2. Definition of Terms - As used in these Guidelines, the following terms shall have the following

respective meanings:

- a. "Act" unless otherwise stated, shall refer to Republic Act No. 9136, otherwise known as the "Electric Power Industry Reform Act of 2001";
- b. "Buyer or Concessionaire" shall refer to the qualified party awarded the sale agreement or concession contract for the Transmission Assets;
- c. "Consortium" shall refer to the juridical entity formed by and composed of two or more Distribution Utilities each of whom is connected to one or more Subtransmission Assets in common with one or more other Distribution Utilities;
- d. "Current Sound Value" shall refer to the market value of an asset taken or the current replacement cost of the asset less accumulated depreciation based on the actual condition of the asset.
- e. "Directly Connected Entity" shall refer to each End-User, person or entity other than a Qualified Distribution Utility, the members of a Franchised Consortium or TRANSCO or its Buyer or Concessionaire that is directly connected to the Subtransmission Assets;
- f. "Directly Connected Generators" shall refer to those generating facilities that normally supply electricity to the Grid and where electricity normally flows from the generator to the Grid;
- g. "Distribution Utility" shall refer to any electric cooperative, private corporation, government-owned utility or existing local government unit which has an exclusive franchise to operate a distribution system in accordance with its franchise and the Act;
- h. "End-User" shall refer to any person or entity requiring the supply and delivery of electricity for its own use;
- i. "Energy Regulatory Commission" or "ERC" shall refer to the regulatory agency created by Section 38 of the Act;
- j. "Franchised Consortium" shall refer to a Qualified Consortium that has been granted a franchise to own, operate, maintain, expand and/or upgrade one or more Subtransmission Assets;
- k. "Grid" shall refer to the high voltage backbone system of interconnected transmission lines, substations and related facilities, located in each of Luzon, Visayas and Mindanao, or as may otherwise be determined by the ERC in accordance with Section 45 of the Act;
- l. "National Transmission Corporation" or "TRANSCO" shall refer to the corporation organized pursuant to the Act to acquire all the Transmission Assets of the National Power Corporation (NPC);
- m. "Qualified Consortium" shall refer to a Consortium of Distribution Utilities whose combined qualifications meet the technical and financial criteria established in Article IV hereof;
- n. "Qualified Distribution Utility" shall refer to a Distribution Utility that meets the technical and financial criteria established in Article IV hereof;
- o. "Subtransmission Assets" shall refer to facilities classified as Subtransmission Assets based on functional standards established in Article III hereof, including but not limited to step-down transformers used solely by load customers, associated switchyard/substation, control and protective equipment, reactive compensation equipment to improve customer power factor, overhead lines, and the land where such facilities/equipment are located. These include NPC and/or TRANSCO assets linking the transmission system and the distribution system, which are neither classified as generation nor transmission; and

p. "Transmission Assets" shall refer to the grid-wide electrical infrastructure through which electricity flows in large quantities between generators or generating plants consisting of several units or blocks of generators and the many more dispersed load centers. Transmission assets are typically characterized as long distance lines, high capacity switching and transformation stations, high degree of meshing of lines, stations that provide patch diversity, and sophisticated protection schemes that ensure security against grid-wide disturbances.

ARTICLE III

Criteria to Distinguish Transmission Assets from Subtransmission Assets

SECTION 1. Removal of References to Specific Voltage Levels - In classifying assets into Subtransmission Assets and Transmission Assets, all references to voltage levels as provided in Section 7 of the Act and Section 5, Rule 6 of the IRR shall not apply following the effectivity of these Guidelines. The assets shall be classified based on the technical and functional criteria specified in Section 2 that follows. Pending disposal in accordance with these Guidelines assets currently classified as Subtransmission Assets are deemed Transmission Assets only for the purpose of necessary and justifiable upgrade and expansion in accordance with Section 8 of the Act.

SECTION 2. Technical and Functional Criteria - The assets shall be classified based on the technical and functional criteria enumerated in Sections 4 and 6, Rule 6, Part II of the IRR of the Act, including, but not necessarily limited to, the following:

a. Directly Connected Generators

Lines, power transformers and other assets held by TRANSCO or its Buyer or Concessionaire, which allow the transmission of electricity to a Grid from one or more Directly Connected Generators, shall be classified as Transmission Assets.

b. Directly Connected End-Users

Radial lines, power transformers, related protection equipment, control systems and other assets held by TRANSCO or its Buyer or Concessionaire which directly connect an End-User or group of End-Users to a Grid and are exclusively dedicated to the service of that End-User or group of End-users shall be classified as Subtransmission Assets.

c. Directly Connected Load-End Substation

Radial lines, power transformers, related protection equipment, control systems and other assets held by TRANSCO or its Buyer or Concessionaire which directly connect a load-end substation of one or more Distribution Utilities to a Grid but no Directly Connected Generators shall be classified as Subtransmission Assets.

Article IV

Qualification Criteria for Distribution Utilities or Consortium of Distribution Utilities

SECTION 1. Technical Capability Criteria - The technical criteria for qualification shall include but not be limited to the following:

a. Should have at least one year experience in the operation and maintenance of a line with voltage level equivalent to that of the Subtransmission Asset to be acquired. A Distribution Utility without the necessary experience should undergo at least a one-month training program from TRANSCO as its own expense.

b. Should have a minimum inventory of materials used for immediate replacement during emergency repair and maintenance of the line.

- c. Should have at least two years experience in the operation and maintenance of substation facilities and have qualified personnel for metering, protection and instrumentation, transformer testing and evaluation. A Distribution Utility without the necessary experience should undergo at least a one-month training program from TRANSCO at its own expense.
- d. Should have a combined weighted average of not more than 80% on reliability performance for the most current year (Interruption Frequency Rate - 50% and Cumulative Interruption Time - 50%). The standard is set at 5 times for Interruption Frequency Rate and 45 hours for Cumulative Interruption Time. A Distribution Utility not meeting the criterion may provide an explanation to be considered by the Commission.
- e. Should have submitted to the ERC its Statement of Compliance to the Philippine Grid and Distribution Codes.
- f. Should be in full compliance with DSC-PGC-019 (Maintenance Program) and DSC-PDC-038 (Maintenance Program) and at least two other requirements of the Philippine Grid and Distribution Codes.

SECTION 2. Financial Capability Criteria - The financial criteria for qualification shall include but not limited to the following based on the most current audited financial statement:

- a. Current on all financial obligations related to all contracts with suppliers of inputs necessary for the Distribution Utility's provision of electricity service to its End-Users;
- b. Current on all financial obligations related to outstanding debt: Provided, That the ERC may grant exceptions in the case of pending debt restructuring;
- c. A current ratio of not less than 0.80:1 or a quick ratio of not less than 0.70:1. The current ratio shall be calculated as the ratio of the current assets to current liabilities. The quick ratio shall be calculated as the ratio of the current assets less inventory to current liabilities;
- d. a debt ratio of not more than 70%. The debt ratio shall be calculated as the ratio of total liabilities to total assets;
- e. An average collection period of not more than sixty (60) days. The average collection period shall be calculated as the ratio of average receivables to daily sales. The average receivables shall be determined using the average of the receivables at the beginning and end of the year. The daily sales shall be computed by dividing sales by 365 days; and
- f. A positive net profit margin and return on assets. The net profit margin shall be calculated as the ratio of net profits after taxes to sales. The net profits after taxes shall be computed as earnings before interest and taxes minus tax (EBIT-Tax). The return on assets shall be computed as the ratio of earnings before the interest and taxes minus tax (EBIT-Tax) to the average total assets.

The Distribution Utility may submit other relevant information to be considered by the Commission in determining the financial capability of such Distribution Utility.

SECTION 3. Determination of Qualified Consortium - Each Distribution Utility comprising a Consortium need not meet all the qualification criteria specified in Sections 1 and 2 hereof for the Consortium to be qualified. If the combined qualifications of the Distribution Utilities outweigh the inadequacies of any unqualified Distribution Utility in the Consortium, the Consortium shall be qualified: Provided, That at least one (1) Distribution Utility in the Consortium complies with all criteria in Sections 1 and 2 hereof.

ARTICLE V

Procedures Prior to Final Sale and Transfer of Subtransmission Assets

SECTION 1. Negotiation of the Sale and Transfer Agreement - TRANSCO shall negotiate a sale and transfer agreement for assets classified as Subtransmission Assets based on technical and functional criteria established in Article III hereof, to all interested Qualified Distribution Utilities or Qualified Consortium connected to such subtransmission facilities. The Qualified Distribution Utility or Qualified Consortium interested in purchasing Subtransmission Assets shall negotiate to acquire all Subtransmission Assets to which they are connected.

SECTION 2. Asset Valuation - Asset valuation shall be the agreed value as negotiated between TRANSCO and the Qualified Distribution Utility or Qualified Consortium in a manner consistent with Section 8 of the Act. This negotiated value shall be deemed to be the Current Sound Value of the Subtransmission Assets at the time the acquisition of the assets. Consistent with Section 43 (f) of the Act, Distribution Utilities may have the assets revalued by an independent appraisal company following three (3) years from the asset transfer date: Provided, That any future appraisal submitted by the Distribution Utility may not adjust the sale value beyond documented incremental changes in inflation and foreign exchange that occur from the date of acquisition to the date of the appraisal. The negotiated value may consider mitigation of possible rate increases to customers paying for the recovery of costs related to Subtransmission Assets.

SECTION 3. Dispute Resolution - In case of disagreement in valuation procedures, ownership participation and other issues, the TRANSCO or its Buyer or Concessionaire, a Qualified Distribution Utility or a Qualified Consortium, may file with ERC a petition for dispute resolution.

All costs arising from, incidental to, or otherwise attributable to the resolution of any petition for dispute resolution shall be borne equally by the parties to the dispute.

SECTION 4. Approval by ERC - Prior to be final sale and transfer of such Subtransmission, the parties shall file with ERC an application for approval on each of the following:

- a. The assets meet the technical and functional criteria for Subtransmission Assets established in Article III hereof;
- b. The Distribution Utility or Consortium meets the qualifications criteria established in Article IV hereof; and
- c. A rate proposal by the Distribution Utility or Consortium for the recovery of the negotiated value and operation and maintenance costs related to the acquired Subtransmission Assets including any proposal to mitigate or otherwise phase in possible rate change impacts if such exist.

In order to facilitate the review and approval of the proposed sale and transfer of Subtransmission Assets by TRANSCO to the Qualified Distribution Utility or Qualified Consortium, ERC shall require the concerned parties, upon filing of the application, to submit the following documents, if applicable:

- a. Description of the franchise area being served;
- b. Description and electrical diagram of the lines, power transformers and other Subtransmission Assets;
- c. Complete listing of any Directly Connected Entity connected to the Subtransmission Assets including the contact details for each Directly Connected Entity;
- d. Complete listing of all Distribution Utilities and any Directly Connected Entity connected to the Subtransmission Assets;
- e. Resolution of the Board of Directors of the respective parties authorizing the sale and purchase of Subtransmission Assets;
- f. Report indicating that assets intended for sale meet criteria for Subtransmission Assets;

- g. Report indicating that the Distribution Utility or the Consortium of Distribution Utilities intending to purchase Subtransmission Assets comply with the technical and financial standards prescribed in Article IV hereof;
- h. All billing determinants that may be used as part of the rate proposal;
- i. Draft agreement between parties to the sale and purchase of Subtransmission Assets; and
- j. All other supporting data, documents, and analysis that may be needed by the ERC in the course of the review.

The ERC shall render its decision within sixty (60) days from the date of submission for resolution of the application, otherwise items enumerated herein requiring ERC approval shall be deemed approved.

SECTION 5. TRANSCO Rates - TRANSCO shall immediately cease billing of the subtransmission rates upon the date of final sale of all connected Subtransmission Assets to a Qualified Distribution Utility or Qualified Consortium but will continue billing the existing subtransmission rates to any entity connected to Subtransmission Assets that have not been acquired by a Qualified Distribution Utility or Qualified Consortium. No later than 27 months following the effectivity of these guidelines, the TRANSCO shall include any remaining assets previously classified as subtransmission in the recalculation of transmission rates. Following approval of the recalculated transmission rates by ERC, TRANSCO shall cease billing all subtransmission rates.

SECTION 6. Procedure for Filing with ERC - Any petition, application or action to be filed herein shall be governed by the existing Rules of Practice and Procedure Governing Hearings before the ERC, the pertinent provisions of the Act or its IRR and other related laws.

Article VI

Application by a Qualified Consortium for Franchise to Own and Operate the Subtransmission Asset

SECTION 1. Eligible Applicant - An application for a franchise shall be filed with the ERC by the Qualified Consortium formed by and composed of two or more Distribution Utilities intending to own, operate, upgrade and expand one or more Subtransmission Assets.

SECTION 2. Submission of Required Data - Upon filing of an application for a franchise, the Consortium referred to in the immediately preceding section shall submit the following documents to facilitate the evaluation of the application for a franchise:

- a. Description of the franchise area served by each party to the application;
- b. Resolution of the Board of Directors of the respective parties authorizing each party to the application to form a Consortium with the other parties to the application;
- c. Description and electrical diagram of each Subtransmission Asset to be acquired by the parties to the application;
- d. Resolution of the Board of Directors of the respective parties authorizing each party to the application to acquire each Subtransmission Asset;
- e. Description and/or electrical diagram of the common connection/s of each party to the application;
- f. Complete listing of any Directly Connected Entity other than the parties to the application, connected to each Subtransmission Asset;
- g. Contact details of the Directly Connected Entity other than the parties to the application, connected to each Subtransmission Asset;

- h. Subscription rights of each party to the application;
- i. Audited Financial Statement; and
- j. Other documents that may be needed by the ERC in the course of the evaluation.

SECTION 3. Procedure for filing with ERC - Any petition; application or action to be filed herein shall be governed by the existing Rules of Practice and Procedure Governing Hearings before the ERC, the pertinent provisions of the Act or its IRR and other related laws.

Article VII

Final Provisions

SECTION 1. Separability Clause - If for any reason, any part or section of these Guidelines is declared unconstitutional or invalid, the other parts or sections hereof which are not affected thereby shall continue to be in full force and effect.

SECTION 2. Effectivity - These Guidelines shall take effect on the fifteenth (15th) day following its publication in two (2) newspapers of general circulation.

Adopted: 17 Oct. 2003

(SGD.) MANUEL R. SANCHEZ
Chairman

(SGD.) OLIVER B. BUTALID
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