THE POLITICS AND DYNAMICS OF ELECTRICITY REGULATION: THE CASE OF ERB AND MERALCO[a]

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A. INTRODUCTION

This paper is a case study of the politics and dynamics of rate regulation in the Philippine electricity industry (PEI). It shows how a set of (regulatory) rules, decisions, laws and jurisprudence was actually arrived at, and implemented by the industry regulator before the Electric Power Industry Restructuring Act of 2001 (EPIRA), e.g., the Energy Regulatory Board (ERB), and the courts. It also shows the consequent effects of these regulatory rules and principles on the Manila Electric Company (Meralco), the largest distribution electric utility in the country, and its consumers.

The case study centers on the narrow notion of regulation, which refers here to “a set of rules, decisions, laws and jurisprudence formulated, taken and adopted by regulators, which are legal and binding on the regulatee and on the regulatory issue at hand.” It focuses ERB Case 93-118, which started as a set of Meralco petitions for rate increases in 1993. It ended in 2003 with the final decision of the Third Division of the Supreme Court (SC) ordering the firm to refund some P28B-P30B to its 3.7 million customers.

B. THE FACTS AND TIMELINE OF THE CASE

Figure 1 pictures the timeline of ERB Case 93-118. The case is a long drawn-out petition that spans the realm of economics, law and politics, and counts ten long years of quasi-judicial and judicial proceedings within the ERB and the courts.

It has included stakeholders other than the movant or petitioner, Meralco and the regulator, ERB. Such included other government bodies like the Commission on Audit (COA), the Office of the Solicitor General (OSG), the Court of Appeals (CA) and the Supreme Court (SC). Non-official but equally important policy stakeholders included private citizens, consumer groups, and industry organizations, all of which are named as the case unfolds.

Fig. 1. The Timeline of the ERB Case 93-118

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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[1] [a] Reference
<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
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<tbody>
<tr>
<td>December 27, 1993</td>
<td>Meralco Applied for Rate Increases (Petition for rate increases/revision of rate schedules and appraisal of properties with provisional authority); docketed as ERB Case 93-118</td>
</tr>
<tr>
<td>January 28, 1994</td>
<td>ERB issued an Order granting Meralco provisional authority to increase rates on the average of P0.184/kWh effective billing cycle of February 1994</td>
</tr>
<tr>
<td>1994-1998</td>
<td>Public Hearings, deliberations, submission of affidavits, petitions, motions, etc. for or against the 1994 ERB Order; dismissal of counter-petitions for lack of merit</td>
</tr>
<tr>
<td>February 19, 1997</td>
<td>COA submitted an audit report of Meralco’s finances, assets, etc.; showed that there were properties that were not used and useful to the operation of the firm but were nevertheless included in the appraisal of properties of Meralco; questioned the inclusion of income tax as part of the firm’s operating expenses</td>
</tr>
<tr>
<td>February 16, 1998</td>
<td>ERB issued an Order reversing its 1994 decision; granted Meralco a lower rate increase (P0.017) and ordered a refund of an average of P0.167/kWh from February 1994 to present</td>
</tr>
<tr>
<td>February 23, 1998</td>
<td>Meralco went to the courts and petitioned the Court of Appeals (CA) to review the 1998 ERB Decision; it also applied for a temporary restraining order and writ of preliminary injunction</td>
</tr>
<tr>
<td>February 24, 1999</td>
<td>The Court of Appeals reversed (set aside) the 1998 ERB Decision</td>
</tr>
<tr>
<td>March 19- December 23, 1999</td>
<td>ERB filed a motion for reconsideration with the CA which denied its motions for lack of merit</td>
</tr>
<tr>
<td>February 18, 2000</td>
<td>ERB filed with the Supreme Court (SC) a Petition to nullify the 1999 CA Decision</td>
</tr>
<tr>
<td>November 15, 2002</td>
<td>The SC reversed the CA Decision of 1999</td>
</tr>
<tr>
<td>November 22, 2002</td>
<td>Meralco filed a Motion for Reconsideration with the SC and petitioned that the matter be discussed by the SC en banc</td>
</tr>
<tr>
<td>April 19 and 30, 2003</td>
<td>The SC ruled with finality affirming the legality of the 1998 ERB Decision ordering Meralco to refund its customers or credit to their future consumption excess charges beginning February 1994</td>
</tr>
<tr>
<td>May 2003-present</td>
<td>ERC ordered an implementation of a refund program for Meralco customers</td>
</tr>
</tbody>
</table>

The study traces the origin of the case to its filing and docketing on December 1993, to its being decided upon by ERB on January 1994. The firm’s petition for rate increase, e.g., “An Application for Approval of Revision of Rate Schedules and Appraisal of Properties with Provisional Authority,” was provisionally granted, “in the average amount of 18.4 centavos per kWh, effective the billing cycle beginning February 1994.”[1]
Thereafter were motions and petitions against the 1994 provisional authority until ERB ordered on July 12, 1995 the dismissal of these motions for lack of merit. It also included ERB orders reiterating its request with COA to submit the latter’s audit examination report on the books of account of Meralco.

The COA complied and submitted a report on February 7, 1997, three (3) years after the provisional authority was granted to Meralco. The COA Report had material effect in reversing the ERB Order of 1994, which the ERB did on February 16, 1998. In reversing its earlier (1994) interim decision, the ERB nevertheless granted a rate increase to Meralco but at a lower level. Corollary, it ordered the firm to refund excess charges from February 1994 to present.

However, Meralco sought redress with the courts and found an ally in the Court of Appeals, which reversed the ERB 1998 decision, in favor of Meralco. The ERB appealed the case with the Supreme Court in 1999 and in 2003, was finally granted a favorable decision affirming its authority over the case and ordering Meralco to comply with the 1998 ERB decision.

A detailed discussion[b] of these events follows below.

1. The Power Crisis and its Effects on Meralco

In a survey conducted by the Hong Kong based Asiamoney magazine in 1992, Meralco ranked second among the Philippine’s best managed companies...based on its adoption of well-tried management techniques, a solid record of performance and an ability to exploit its lines of business.[2] However, years after, Meralco experienced challenges far greater than it anticipated.

The year 1993 “leaves a black mark in the history of the Philippine electricity industry” because it was the height of the crippling power crisis that adversely affected the economy and society. This severe power shortage[c] depressed Meralco’s sales by 0.2% from the 12,279.4 million kilowatt-hours sales sustained in 1992 to 12,251 million kilowatt-hours sales a year later.[3]

As a response to the crisis, Meralco streamlined its operations and rationalized costs, making possible a respectable net income of P1.63 billion. This, however, represented a 12.5% decrease from the P1.86B net income in 1992.[4] Operating expenses grew by only 8.8% from the P29.7B in 1992 to only P32.3B in 1993, despite the fact that it pursued all its programs at a much faster pace. Customer base also increased by 6.8% from 2.152M in 1992 to 2.297M in 1993 (see Table 1 below).

### Table 1. Highlights of the Corporate Status of Meralco, 1992-1993

<table>
<thead>
<tr>
<th>Indicator</th>
<th>1992</th>
<th>1993</th>
<th>% Change</th>
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<td></td>
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In addition, despite cash flow deficits, Meralco continued its capital expenditures programs with funds obtained from the public offering of its shares of P869M and additional borrowings from Citibank, Asian Development Bank (ADB), and other funding agencies. Overall, the RORB computation of Meralco for 1993, with an adjusted rate base of P27.564B, was only 5.5%, way below than the rate required of its creditors.[5]

Thus, on December 28, 1993, Meralco filed with the ERB an application for rate increase with provisional authority. This was later known and referred to as ERB Case 93-118.

2. **ERB Case 93-118: Application for Rate Increase/Restructuring of Rate Schedules**

In the ERB Case 93-118, Meralco proposed the adoption and approval of the following rate schedules (Table 2):
These reflected an average increase of 21 centavos per kWh in the applicant’s distribution charge, which was 7.5% of the November 1993 average billing rate. Of these proposed increases, Meralco computed a 7.8 centavos per kWh-cost recovery for Income Tax and the Franchise Tax, which amounts, according to the applicant firm, “would accrue to the government.”

The application also included the incorporation into the Basic Distribution Charge of the Currency Exchange Rate Adjustment (CERA I and II) up to P29.805 to US $1.00, which was the same exchange rate used in Meralco’s latest (1993) asset appraisal.[6]

More specifically,

a. The proposed Residential and General Service Schedule (RGS-3) would continue to provide subsidized rates to the first 50 kWh consumption of customers consuming not more than 300 kWh per month. The subsidized consumption would be charged P1.81 per kWh, which was less than the 1993 cost of purchased power of Meralco from the NPC at P1.8735 per kWh.

Meralco added that a 16% discount on the Basic Distribution Charge would be extended to educational institutions duly registered with and certified by the Department of Education (DepEd) and private hospitals duly registered with and certified by the Bureau of Medical Services (BMS) covered by the proposed RGS-3.[7]

The effects on the monthly electric bills of typical residential customers at various consumption levels, as estimated by the utility company, were as follows:

<table>
<thead>
<tr>
<th>A customer consuming 1993 bill of</th>
<th>would pay</th>
<th>in addition to the</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) 50kWh/month</td>
<td>P 10.00 ($0.34) more</td>
<td>P 80.50 (US$2.70)</td>
</tr>
<tr>
<td>2) 100kWh/month</td>
<td>P 20.95 ($0.70) more</td>
<td>P 244.16 (US$8.19)</td>
</tr>
<tr>
<td>3) 200kWh/month</td>
<td>P 42.84 ($1.44) more</td>
<td>P 571.49 (US$19.18)</td>
</tr>
<tr>
<td>4) 500kWh/month</td>
<td>P121.82 ($4.09) more</td>
<td>P 1, 624.28 (US$54.50)[e]</td>
</tr>
</tbody>
</table>

b. The proposed Non-Industrial Service schedule (NIS-3) was estimated to increase the rates to non-industrial customers by about 23 centavos per kWh or 7.9% of their 1993 billing rates.

c. The proposed Industrial Service schedule (IS-3), inclusive of the Primary Metering Discount and Power Factor adjustment in the NIS-3, would reflect 18.5 centavos per kWh increase or 6.8% of the 1993 average billing rates. This increase, which was lower than the overall average increase of 21 centavos per kWh, further widens the gap between industrial and non-
industrial rates, in support of the government’s efforts towards industrialization. [8]

d. The charges under the proposed Government Hospitals and Metered Streetlighting Service (GHMS-7) at P1.81 per kWh were the same as the first 50 kWh of RGS customers consuming not more than 300 kWh per month. This schedule would also be applicable to traffic lights as certified by the Traffic Management Center (TMC) and charitable institutions duly registered with and certified by the Department of Social Welfare and Development (DSWD). They would continue to shoulder only one-half of future increases in the cost of purchased power.[9]

e. The proposed Flat Streetlighting Service schedule (FS-8) would also reflect an average rate increase of P1.81 per kWh. Customers falling under this schedule would likewise shoulder only one-half of the future increases in the cost of purchased power.[10]

Meralco opined that “the proposed rate schedules, if applied to the restated rate base of 1993 in the amount of P31.292B would result in a rate of return equivalent to 10.5%, which is well below the 12% RORB allowed of distribution utilities.”[11]

Meralco also noted that the last rate increase ERB granted the distribution utility was on October 1990, which became effective on November 1990 and thereafter.[12] Under these rate schedules, Meralco estimated a total cash deficit from its 1994 operations, in the amount of P5.312 billion. In addition, the projected operating income of the utility firm for 1994 would be only 5.2% of the rate base, which is very much below the 12% RORB allowed of electric utilities.

Thus, movant Meralco prayed that its proposed rate schedules/petition for rate increase be provisionally and immediately approved by ERB under Section 16 (c) of the Public Service Act (PSA)[1] and Section 8 of EO 172[2]. It also hoped to be authorized to adopt and implement them (new rate schedules) effective upon such provisional approval; and that after hearing, that said schedules be approved finally. The firm also hoped that the regulator would find such relief as just and equitable.[13]

Meralco provided in support of its petition a number of supporting documents, affidavits, and reports for ERB’s perusal. It also assured ERB that, “Should the regulator grant provisional approval and after hearing, decide to reduce the interim rates, the excess collection should be correspondingly credited to the customers.”[14]

Finding the Meralco petition sufficient in form and substance, and the required fees having been paid, the ERB issued an Order and Notices of Public Hearing, both dated January 3, 1994 setting the case for hearing on January 31 and February 1, 1994. [15] At that time, the ERB was composed of Rex Tantiongco (Chairman), Oscar Ala, Bayani Faylona, Arnaldo Baldonado and Edward Castaneda (Members). [h]

Copies of the Order were also furnished the Office of the Solicitor General (OSG) and the Commission on Audit (COA), which were requested to have their duly authorized representatives present at the hearing. [16]

On January 5, 1994, the Board received an “Urgent Ex-Parte Motion for Provisional Approval of the Revised Rate Schedules” from applicant Meralco. It is a reiteration of the urgency (from the point of view of Meralco) for ERB to act on the firm’s proposal, citing below-the required RORB it was experiencing (5.5%) vis-à-vis the requirement of its creditors. On January 7, 1994, the ERB directed the applicant to submit a copy of its loan agreements with the World Bank (WB) and the ADB, containing covenants requiring a minimum 8% RORB. Meralco complied with this requirement on January 29, 1994. [17]

On January 10, 1994, ERB received a letter from the Federation of Free Workers (FFW), requesting for copies of the Meralco application. On January 11, 12, 13, 14, 1994, the oppositions of the Kilusang Mayo Uno (KMU), Federation of Concerned Organization of Balut [i] (FCOB), Trade Union Congress of the Philippines (TUCP), and Mrs. Belen Hernandez Atendido, respectively, were received by the Board. [18] The latter was representing the jeepney owners and operators of Metro-Manila.

On January 14, 1994, Azcuna Yorac Sarmiento Arroyo and Chua Law Offices [j] filed its entry of appearance as co-counsel for Meralco. On January 18, 1994, Mr. Genaro Lualhati filed his opposition to the instant application. On January 25, also of the same year, the Philippine Consumers Foundation, Inc. (PCFI) and Mr. Elpidio Isip filed a “Motion to Inhibit (presiding over the case)” against Chairman Tantiongco, for allegedly defending Meralco’s petition in one television interview. On the same date, the Municipality of Sampaloc, Province of Quezon filed Resolution No. 94-01 opposing said application. [19] Mr. Isip filed his motion as a private citizen.
4. ERB Order of January 28, 1994 Granting Provisional Authority to Increase Rates

The Board accordingly made an evaluation of Meralco’s application and urgent motion, as well as the counter-motions, affidavits and other documents of different groups and individuals supporting or opposing said application and motion. Then, it came up with these considerations or criteria in acting on rate applications where provisional approval is prayed:

1. Whether the applicant has experienced a distinctive decline in revenue and the revenue deficiency is due to its inability to earn its authorized rate of return. The financial position of the applicant has deteriorated to such extent that it has a depressed rate of return (Michigan Consolidated Gas Co., 38 PUR 4th 272);

2. Whether the applicant’s operating income is not sufficient to cover the cost of interest on its present debt (Re: Milwaukee & S. Transport Corporation, Co., 35 PUR). Hence, it will have difficulty arranging debt financing;

3. The interim rates are necessary for applicant to provide normal services; and

4. The interim rates are needed to prevent a reduction of normal maintenance program (Re: Municipality of Anchorage, 37 PUR 4th 97).

The ERB found the grant of an interim rate relief to Meralco “in consonance with these criteria. In addition, it noted that the firm would indeed suffer the projected cash deficit if such relief were withheld. With such cash deficiency, the firm would indeed be unable to undertake its programs to maintain its distribution system, as well as expand its facilities to serve new customers.”

The Board opined that “Meralco would be unable to cope with the high growth in electric demand resulting from the forecasted (sic) improvement in the power supply situation and the resurgence of the economy.”

It could also not ignore “the fact that Meralco was in technical default of its loan covenants with the WB and ADB. Such situation, if allowed to continue, would cause further difficulties to the applicant, in terms of its inability to further draw on already committed credits.”

The ERB, however, noted that as of the date of filing the application, e.g., December 28, 1993, “the peso-dollar exchange rate was only P27.772 to US $1.0, and that Meralco used P29.805 =US $1, in computing the appraisal increase on its utility plant in service. Using the lower exchange rate, the rate of return corresponding to P0.21 per kWh increase would be 10.7%, instead of 10.5% as set forth in its Normalized Income Statement for 1993. In this light, and to make allowance for possible divergence between applicant’s projections and the eventual actual figures, the Board deemed it prudent to grant applicant an average increase
of only P0.184 per kWh (which would mean a 10% RORB), instead of P0.21 as prayed for.\footnote{23}

The Board also evaluated the substance of the counter-motions of KMU, TUCP, PCFI, and Mr. Lualhati, and “dismissed them for lack of merit.” The KMU Labor Center (KMU-NCR)’s position, for example, was that pending cases involving rate increases of NPC should be resolved first before Meralco’s application was heard by ERB. The Board argued that application of NPC for generation charges and Meralco’s for distribution charges were distinct and separate issues that it would decide separately. KMU’s contention that Meralco was not losing but even generating net income was rebuffed, arguing that the issue and jurisprudence with respect to fixing rates of utilities was not the net income but the RORB.\footnote{24}

Thus, as prayed for, on January 28, 1994 or \textit{after a lapse of only a month}, the Board issued an order granting provisional authority (PA) to applicant Meralco, the dispositive portion of which reads as follows:

\begin{quote}
WHEREFORE, premises considered, and in accordance with Section 8 Of Executive Order 172 and the applicable provisions of the Public Service Act, as amended, \textit{this Board hereby provisionally authorizes applicant Manila Electric Company to adopt and implement the attached rate schedules embodying the aforementioned rate adjustment in the average amount of 18.4 centavos per kWh, effective with respect to applicant’s billing cycles beginning February 1994.}

\textit{In the event, however, that the Board finds, after hearing and submission by the Commission on Audit of an audit report on the books and records of account of the applicant, that the latter is entitled to lesser increase in rates, all excess amounts collected from the applicant’s customers as a result of this Order shall either be refunded to them or correspondingly credited in their favor for application to electric bills covering future consumption.}

\textit{The Commission on Audit, which is furnished with a copy of this Order, is hereby requested to cause an audit and examination of the books and other records of account of the applicant for such}
\end{quote}
period of time, which in no case shall be less than twelve (12) consecutive months, as it may deem appropriate, furnishing this Board with a copy of the audit report thereon immediately upon its completion.” [25].

This Order was concurred and signed by all members of the ERB, e.g., Chairman Tantiongco, Members Ala, Faylona, Baldonado and Castaneda.


The next four years after the 1994 provisional authority (PA) was granted to Meralco saw an exchange of motions, counter-motions, requests and petitions from supporters and oppositors of Meralco, and other concerned stakeholders. These were all carried out under the ambit of the ERB.

The protagonists in this case (ERB 93-118) and their corresponding positions and motions, are found below (Table 3):

Table 3. The Protagonists in the ERB Case 93-118 and Their Positions and Motions

<table>
<thead>
<tr>
<th>Protagonists</th>
<th>Position/Motion</th>
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<tbody>
<tr>
<td>FOR MERALCO’S RATE INCREASE</td>
<td>Legal Counsel of Meralco- defended Meralco’s application and answered the motions filed by the oppositors</td>
</tr>
<tr>
<td>Attys. Manuel Torres, Haydee Yorac and Ruelito Soriano</td>
<td>Served as witnesses for Meralco in the ERB Hearings; testified on the projections, computations, financial and other conditions of the company</td>
</tr>
<tr>
<td>Mr. Rodolfo Quetua, Mr. Jesus Francisco, Mr. Daniel Tagaza, Mr. Nelson Fontanilla, Mr. Roman Felipe Reyes, Mr. Benito Dela Cruz, Officers of Meralco</td>
<td>AGAINST MERALCO’S RATE INCREASE</td>
</tr>
<tr>
<td>AGAINST MERALCO’S RATE INCREASE</td>
<td>Questioned the authority of ERB to grant provisional authority without prior hearing</td>
</tr>
<tr>
<td>Atty. Ceferino Padua, representing Lawyers Against Monopoly and Poverty (LAMP) Mr. Cesar Escosa, representing the Philippine Justice Foundation</td>
<td>Moved to set aside the January 28, 1994 Order of ERB Filed a motion for the issuance of subpoena and subpoena duces tecum against COA and the BIR; also filed an “Urgent Ex-Parte Motion to Stop Meralco from Collecting Power Investment Generation Funds from the Consuming Public, with Prayer for Refund” Presented its Sanggunian Resolution opposing the application of Meralco Questioned the motives of Meralco’s rate increase application</td>
</tr>
<tr>
<td>City of San Pablo, Laguna Mrs. Belen Hernandez Atendido, representing the Jeepney Owners and Operators of Metro-Manila Mr. Raul Concepcion, president of the Federation of Philippine Industries and chairman of the Multi-sectoral Task Force on Energy</td>
<td>Appeared as Intervenor and moved for a “Motion for Reconsideration” of the ERB’s January 28, 1994 decision</td>
</tr>
</tbody>
</table>
Atty. Potenciano Flores, Jr., representing KMU Manifested that the Board cannot issue provisional authority since it had not yet acquired jurisdiction over the application

FCOB Filed an “Urgent Petition for Immediate Rollback of Meralco’s Provisional Rate Increase”

Mr. Genaro Lualhati Filed a “Motion for Reconsideration” alleging that the rate increase of Meralco was unnecessary

Mr. Jose Elpidio Isip Filed a “Motion for Reconsideration on ERB Decision and on Motion to Inhibit against Chairman Tantiongco”

BAYAN Filed a “Motion to Set Aside” the January 28, 1994 ERB Order, alleging that it was issued without due process of law as it failed to justify Meralco’s entitlement to a rate increase

Philippine Exporters Confederation Inc. (PHILEXPORT) Opposed the ERB Order, stating that the prevailing rate structure of Meralco was patently discriminatory against small and medium scale industries

The Board heard all their pleadings, manifestations, evidences, allegations, counter-motions and petitions. Then, it came up with the following decisions:

1) In an Order dated April 29, 1994, the Board denied all motions for reconsideration filed by the oppositors on the ground that its authority to grant provisional relief *ex-parte* and without prior hearing upon filing of an application, or at any stage of the proceedings has been consistently upheld by the Supreme Court. The Board likewise denied the motion to inhibit against the ERB Chair on the ground that an opinion expressed (in a television interview) is not a prejudice or prejudgment at least when held by someone required and accustomed to hold opinions subject to confirmation or rejection.

2) In an Order dated March 2, 1995, ERB informed oppositor Isip that his motion to inhibit has long been resolved by the Board. With regard to his motion to dismiss the instant application, (on the ground that the counsels of Meralco may not be duly authorized to speak for the firm) the Board ruled that counsels for Meralco were presumed to have authority from Meralco’s Board of Directors. This presumption is supported by Section 21, Rule 138 of the revised Rules of Court. Besides, Meralco submitted the Secretary’s Certificate, approving and confirming the actions of Meralco counsels.

3) In an Order dated February 29, 1996, the Board denied the motion to stop Meralco from collecting Power Investment Generation Funds from the consuming public, with prayer for refund. It said, the issues raised therein have long been resolved by the ERB.
4) In its Orders dated December 6, 1995, May 16, 1996, July 31, 1996 and February 5, 1997, COA was again requested to furnish the Board a copy of its audit report.

The Commission on Audit’s opinion was sought in 1994-1997, based on the provisions of CA 325, which read partly as follows:

“Section 1. Hereafter the audit and examination of the books, records and accounts of all public services as contemplated in section 17 (g) and (h) of CA 146 and/or in connection with the fixing of rates of every nature, shall be performed by the General Auditing Office (now COA), through the representatives duly designated therefore by the Auditor General.

Whenever public interests so demand and/or whenever the Public Service Commissioner or a Committee of the National Assembly (now Philippine Congress) so requests, the Auditor General shall cause to be made an examination into the financial condition of any public service under the jurisdiction of the PSC (now ERB). The public service/s concerned shall submit to the Auditor General or his duly authorized representatives all such reports, records and other materials whatsoever may be required. Under such examination, the Auditor General or his representatives shall have the power to examine under oath any official and employee of such public services.”[29]

Section 7 of EO 292 (Administrative Code of 1987) also states that the COA (Special Audit Office) shall “perform the function of auditing financial operations of public utilities and franchise grantees for rate determination and franchise tax purposes.”[30]

The ERB received COA Audit Report SAO No. 95-07 on Meralco’s books of account and related records on February 19, 1997, a good four (4) years after the controversial January 28, 1994 PA Order. This triggered another round of public hearings in ERB, which resulted in the ERB Decision of February 16, 1998.


The COA Report
SAO Report 95-07 is the report on the rate audit of Meralco’s book of accounts. The audit was conducted by a team from COA’s Public Utility Audit Division (PUAD), Special Audit Office (SAO), in compliance with COA Assignment Order 95-016 dated February 3, 1995 and in response to the request of the ERB contained in its January 28, 1994 decision re Case 93-118. [31] This decision granted Meralco a provisional rate increase of P0.184 per kWh effective February 1994.
The COA audit covered the operations of Meralco from February 1, 1994 to January 31, 1995, a period immediately after the implementation of the provisional rate increase.

The results of the audit were derived through tests and analyses of accounts affecting the computation of the rate of return. It involved:

a) the analysis of the operating revenue account to determine the actual operating revenue realized for the test period,

b) analysis of the property and related accounts and ocular inspection of major plants and facilities to determine those not used or irrelevant in operation,

c) vouching of expenses and supporting documents to determine those that should not be included for rate-fixing, and

d) other procedures deemed necessary under the circumstances...

Among others, the audit disclosed the following findings and recommendations:

1. Meralco’s rates of return, based on two assumptions, e.g., a) that income tax is not an operating expense; and b) that income tax is part of the operating expenses, were as follows:

   a. Based on the first assumption, which COA in turn based on the Supreme Court decision on PSC vs. Meralco Case Nos. 85889, 89890, 89893 dated December 27, 1957, the firm’s total invested capital for the period stated yielded a 32.05% and 21.04% rates of return at cost and at appraised values of property, respectively. To reiterate, considering income taxes of P2.14 billion as non-operating expenses, the following computations were arrived at (Table 4):

   These were based on the view adopted by COA that “income taxes should be shouldered by the company’s stockholders who are recipient of income realized from operations of business.”

   With this consideration, Meralco had excess revenue of P4.474B-P2.724B from February 1, 1994 to January 31, 1995. This is a marked turnaround to the P5.3B cash deficit projected by the firm in 1993.

<p>| Table 4. COA Computations with Income Tax Considered Not An Operating Expense of Meralco |
|---------------------------------------------------------------|---------------------------------------------------------------|
| <strong>At Historical Value</strong>                                      | <strong>At Appraised Value</strong>                                        |
| Total Invested Capital Entitled to Return                    | P22,323,113,614                                               | P30,146,154,509                                               |
| 12% Return Thereon                                           | P 2,678,773,634                                               | P 3,617,538,541                                               |
| Add Total Operating Expenses for Rate Determination Purposes | P37,350,812,262                                               | P38,162,503,175                                               |
| Computed Revenue                                             | P40,029,585,896                                               | P41,780,041,716                                               |
| Actual Revenue                                               | P44,504,297,491                                               | P44,504,297,491                                               |</p>
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<tr>
<th></th>
<th>At Historic Value</th>
<th>At Appraised Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Invested Capital Entitled to Return</td>
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<tr>
<td>Add Total Operating Expenses for Rate Determination Purposes</td>
<td>P39,486,451,262</td>
<td>P40,298,142,175</td>
</tr>
<tr>
<td>Computed Revenue</td>
<td>P42,165,224,896</td>
<td>P43,915,680,716</td>
</tr>
<tr>
<td>Actual Revenue</td>
<td>P44,504,297,491</td>
<td>P44,504,297,491</td>
</tr>
<tr>
<td>Excess Revenue</td>
<td>P 2,339,072,595</td>
<td>P 588,616,775</td>
</tr>
<tr>
<td>Percent of Computed Revenue to Actual Revenue</td>
<td>94.74%</td>
<td>98.68%</td>
</tr>
<tr>
<td>Percent of Excess Revenue to Actual Revenue</td>
<td>5.26%</td>
<td>1.32%</td>
</tr>
<tr>
<td>Percent of Excess Revenue to Invested Capital</td>
<td>10.48%</td>
<td>1.95%</td>
</tr>
<tr>
<td>Authorized Rate of Return</td>
<td>12.00%</td>
<td>12.00%</td>
</tr>
<tr>
<td>Actual Rate of Return</td>
<td>22.48%</td>
<td>13.95%</td>
</tr>
</tbody>
</table>

Source: SAO 95-07 Report, 1997

Based on the second assumption, the rates of return considering income taxes as operating expenses or expenses recoverable from consumers, were as follows (Table 5):

Based on this, Meralco had excess revenue for the aforementioned period amounting to P2.339B to P.588B.

COA then counseled ERB to use its sound judgment in resolving the issue of whether income taxes should be part of the operating expenses or not. Based on COA computations, the actual rate of return of Meralco, at historical value or cost, without factoring income tax and including such in Meralco’s operating expenses, was at 32.05% and 22.48%, respectively. Its rate of return at appraised values of property was 21.04% and 13.95%, respectively. These levels still exceed the authorized rate of return for electric utilities of only 12%. Their variance ranges from 175.33%-267.08% at cost, and 116.25%-187.33% at appraised values of property.
2. Meanwhile, the following expense or revenue items of Meralco were either reclassified, added back, or deducted from other items by COA (Table 6):

<table>
<thead>
<tr>
<th>Meralco Item</th>
<th>COA Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Various items of property and equipment either used by affiliates, held for future use, or not essential with a total cost of P2.68B and appraisal increase of P340.5M</td>
<td>Segregated from the rate base and accordingly reclassified to “Electric Plant Not In Service” account</td>
</tr>
<tr>
<td>Related expenses totaling P55.4M</td>
<td>Excluded from operating expenses and reclassified to Miscellaneous Deductions from Income</td>
</tr>
<tr>
<td>Adjustments to current operating revenue totaling P106.9M pertaining to prior year’s electric bills which should have been appropriately charged to “Unappropriated Retained Earnings”</td>
<td>Added back to “Operating Revenue”</td>
</tr>
<tr>
<td>Subsidy to various customers for use of generator sets totaling P3.383M charged back to “Miscellaneous Electric Revenue” account</td>
<td>Added back to “Operating Revenue” for rate determination purposes. The subsidy should have been taken up as expense. Correspondingly, the same amount was added back to “Miscellaneous Expenses”</td>
</tr>
<tr>
<td>The estimated gain on systems loss capacity for 1994 representing the difference between the estimated cost of power purchased based on actual kWh sales, adjusted with the standard 15% systems loss and 3% company use, and the actual power purchased amounting to P96,699,611 deducted from “Operating revenue” account to recognize the gain</td>
<td>Added back to “Operating Revenue”</td>
</tr>
<tr>
<td>A total of P46.826M representing NPC rebates for February, March and April 1994 taken up as Purchased Power at gross amount</td>
<td>Deducted from Purchased Power account to effect the rebates</td>
</tr>
<tr>
<td>Excess provisions for certain items of expenses totaling P69.18M</td>
<td>Deducted from “Operating Expense” and reclassified to “Miscellaneous Deductions from Income”</td>
</tr>
<tr>
<td>Operating Expenses totaling P2.27B which did not meet the criteria set to be allowable for rate determination</td>
<td>Reclassified to “Miscellaneous Deductions from Income”</td>
</tr>
</tbody>
</table>


According to COA, its SAO 95-07 Report was discussed with Meralco management officials in an exit conference held on August 25, 1995 and their comments/justifications were incorporated in the report, where appropriate. It also acknowledged the cooperation extended to the audit team by the officers and staff of Meralco.\[36\]

**Meralco’s Counter-Claims**

This COA report was subjected to scrutiny in the subsequent public hearings called for by the ERB. In addition, and because of its unfavorable effect on Meralco, it attracted a Memorandum from the firm, disputing its findings and audit.\[m\] Meralco alleged that “COA departed from decisions of courts, including the
ERB’s, from generally accepted principles of rate making, as well as accounting principles...”[37]

a) **COA erred in the issue of Income Tax**

Meralco averred that on the issue of whether to include income tax or not as part of operating expenses, COA either misappreciated the Supreme Court (SC) decision or reversed itself against previous audits.[38]

The 1957 SC decision on PSC vs. Meralco Case Nos. 85889, 89840 and 89893, as cited by COA in disallowing income tax as part of operating expenses, “was never affirmed by the SC, but remained set aside and therefore, never gained doctrinal value.”[39] In the said case, “the SC found that the PSC decision was rendered without having given Meralco “its day in court” in violation of its right to due process of law. Accordingly, it was ordered set aside, the case remanded to PSC for further proceedings.”[40]

Moreover, according to Meralco, “even as it expresses reliance on the PSC decision on income tax, the COA itself contravenes the ruling therein, to wit:

Xxx In this case, we (PSC) agree with the view of the New York State Public Service Commission cited by Meralco in the treatment of income tax as an income deduction rather than as an operating expense... (page 21) ’’[41]

The firm elaborates,

“In rate making, operating expenses are deducted from gross income to arrive at the net income. In turn, the net income is divided by the rate base to arrive at the rate of return. As such, deducting income tax directly from income (as PSC directed) will have the same effect on net income as when the same amount is recognized as part of operating expenses. In its report, COA did not follow the PSC ruling that income tax should be treated as “an income deduction.”[42]

Be that as it may, even granting the ambiguity of some of the decisions of the PSC, Meralco opined that *it is now well settled that income tax is properly treated as an operating expense*. This, in the light of the decisions of the ERB on numerous rate applications of utilities, including the First Philippine Industrial Corporation (FPIC) and Cotabato Light and Power Co., Inc. (Cotabato Light) cases.[43]

Our own Supreme Court, Meralco volunteered, has also ruled that franchise tax, which has been deemed to be “in lieu” of income tax, is properly allowed as part of operating expenses.[44]
Be that as it may, as earlier pointed out, with or without the income tax, the COA audit found the firm to be earning excess revenue from P588B to P4,474B. Its RORB was 13.25% to 32.05%, way above the authorized RORB of 12%.

b) **On the disallowance of proportionate value of property and equipment in service, On various exclusion from property and equipment in service, and Others**

Applicant Meralco has also commented on the other aspects of the COA Report.

More particularly,

1) Meralco argued that there should have been no issue with respect to its computation of its property and equipment in service account. This is because COA stated that it has “no objection on the use of average investment method for the computation of rate base,” or “proportionate value of assets” method, which allows for a return on the property and equipment only for the number of months they were in service during the test period covered.[45] However, in disallowing a number of items here, COA used as basis the “date acquired” or “year-end rate base” method. The latter considers a property as part of the rate base only beginning from the month it is acquired. Meralco supplied the relevant provision in the PSC decision on Case 858889, 89890 and 89893, 1957, which states, thus:

> “Since we find that Meralco’s net earnings are keeping pace well with the operating costs and additions made to plant, it is our opinion that there is no compelling reason or circumstance for us (PSC) to depart from the use of the net average investment rate base in the instant cases.”[46]

2) It also argued against the exclusion of a number of its properties and equipment in service, in the same account. More specifically, it said:

a) The Meralco Theater “is being used for seminars, conferences, meetings, presentations, etc. by different organizations in the Company, such as the Work Improvement Teams, quality circles, etc.”[47] Consistent with the Supreme Court Ruling in Republic vs. Medina (41 SCRA 643), if a property “contributes to the efficiency of the employees in the performance of their work and therefore benefits perhaps indirectly the public that they serve” (at 664), the same should not be disallowed.[48]

b) There is double deduction from its operating expenses in the account, Jollye Recreation Center and John F. Cotton Hospital.[49] In addition, the SC has already ruled (?) that the shooting range in the Jollye Recreation Center and the Center as a whole is “a place where
employees engage in sports and athletic activities, and thus indirectly benefiting the public they serve.\[50\]

c) The COA also deducted from the firms’ rate base the total value of the Computer Information System (CIS) Building. Such deduction was unreasonable because “1) certain parts of the Building (such as the Meralco Training Division, conference rooms) were being used by the applicant; 2) about 70% of the business of CIS (which used to be a department of the firm) pertained to computer services rendered to applicant at a much lower cost because of CIS’ 30% outside business.” Meralco countered that “at most, only 30% of the value of the CIS Building should be excluded.\[51\]

d) On other expenses disallowed, Meralco again cited the Supreme Court decision that found “advertising, life insurance premiums and other fringe benefits to employees, (which) certainly did not go to the stockholders of the company and largely contributed to its trouble free service and labor relations” as allowable expenses (at 664).\[52\]

e) Based on Meralco’s 1994 Annual Report, its RORB was only 11.4% and not 32.05% as computed by COA.\[53\]

In sum, Meralco opined that the findings of COA were without any basis, in fact and in law.\[54\]

The 1998 ERB Decision
While the case was being heard and claims and counter-claims by various parties assessed and studied, the Board conducted its own investigation, ocular inspections and evaluations to arrive at a final decision with regard to ERB Case 93-118. Its main concern as of 1997-1998 was to ascertain whether or not the provisional increase granted in 1994 in the amount of P0.184/kWh is fair and reasonable, and within the maximum 12% allowable RORB.\[55\]

In determining the reasonable rate of return of Meralco, the ERB considered the following elements:

1. Gross revenue under the rate structure being examined
2. Operating expenses appropriately incurred to produce the gross revenue
3. Property and equipment that provide the service which represent the base on which the return should be based (this should also be stated at the fair market value)
4. Percentage to be applied to the rate base in order to establish the return to investors.\[56\]

**Value of Assets**

The objective in assessing item 3 is to determine the value of the property used and useful in rendering a designated public utility service at the time of evaluation. The term “used” means the property was employed in accomplishing something and the term “useful” means the property is capable of being put to use, having utility, advantageous, producing or having the power to produce, serviceable for a beneficial end or object.\[57\]

A property is also “used” and “useful” when it is presently used in providing utility service, has been used on occasions in the recent past, and shall be used immediately or for a reasonable future period.\[58\]

Thus, after the Board’s ocular inspections on July 10-14, 1995 and August 7-11, 14 and 15, 1995, and reconciling them with the AACI Appraisal Report\[n\] of Meralco’s assets in service, it did a recomputation as follows (Table 7):

<table>
<thead>
<tr>
<th>Table 7. The ERB’s Recomputation of Meralco Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost of Reproduction, New</strong></td>
</tr>
<tr>
<td>Total Value of Assets in Service as of December 31, 1992</td>
</tr>
<tr>
<td>Adjusted Value of Assets in Service</td>
</tr>
</tbody>
</table>

Source: ERB Decision of 1998, p. 3

In effect, the ERB agreed with the COA findings in disallowing some properties and equipment which were not used and/or useful in the operation of the utility. The deducted amounts (P.643B and P.270B in cost of reproduction, new and sound value, respectively) represent the ERB’s inspection report findings that “some properties were either not directly related to the operation of the business, retired, or not used/useful in the operation of the firm.”\[59\]

These properties were the ones listed above, with net book value of some P2.5 billion, after COA’s disallowance. To reiterate, these properties include the Meralco Theater, Shooting Range, John F. Cotton Hospital, Jollye Recreation
Center, and the CIS Building. COA disallowed their inclusion in asset valuation on the grounds that
1) these properties and equipment are either used by its affiliates (not directly by Meralco),
2) held for future use, or
3) are not essential in the utility’s operation.[60]

The ERB affirmed the findings of COA in this regard (disallowances) and explained that

The Board adheres to the well-settled principle in rate making “that only property and equipment used and necessary in rendering service to the utility’s patrons or customers is entitled to a rate of return. Any property or equipment which fails to meet this criterion even if actually owned or in possession of the utility should be discarded from the rate base as it will not be reasonable and just for the customers to pay a charge on a property or equipment which is not actually devoted for public service, and useful and necessary in rendering service to them.”(PSC Case Nos. 85889, 85890 and 85893, Meralco vs. Pedro Gil[61]

The Board also adopted COA’s position in segregating various properties found not in service in its ocular inspection. These properties were as follows: various parcels of land, the Rockwell Thermal Power Plant, the Long Ranger Helicopter, construction work in progress and the offices held by its affiliates, particularly Mesala and PCIB. As in the properties aforementioned, the Board believed that “it seems not fair to the customers if assets not yet in service will qualify to be part of the rate base.”[62]

After assessing point by point all the counter claims of Meralco against the COA Report, scrutinizing the latter and relying on its own assessment after its inspections and other studies, the ERB came up with the following summary of findings on the appraisal of Meralco’s assets. This is the Rate Base in computing the RORB (Table 8):

Table 8. ERB’s Computation of Meralco’s Rate Base

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets Entitled to Return per COA</td>
<td>P24,238,759,414</td>
</tr>
<tr>
<td>Add: ERB Adjustments</td>
<td></td>
</tr>
<tr>
<td>a) 50% value of MeralcoTheater</td>
<td>29,277,056</td>
</tr>
<tr>
<td>b) Meralco Shooting Range</td>
<td>2,702,305</td>
</tr>
<tr>
<td>Adjusted Net Book Value of Assets Entitled to Return</td>
<td>P24,270,738,775</td>
</tr>
<tr>
<td>Less: Assets Found by ERB Inspection Team</td>
<td></td>
</tr>
</tbody>
</table>
Operating Revenue

The Board reconciled the figures as audited by COA (P44,504,297,492) and as reported by Meralco (P44, 278,312,000), or a difference of P225,985,492, and came up with the following computation of operating revenues (Table 9):

Table 9. ERB’s Computation of Meralco’s Operating Revenues

<table>
<thead>
<tr>
<th>Revenue as Reported by COA</th>
<th>P 44,504,297,492</th>
</tr>
</thead>
<tbody>
<tr>
<td>Add/(Deduct) Adjustments</td>
<td></td>
</tr>
<tr>
<td>a) Prior Period Adjustments in Bills</td>
<td>(81,331,780)</td>
</tr>
<tr>
<td>b) Gain in System Loss Capacity</td>
<td>(96,599,611)</td>
</tr>
<tr>
<td>c) Revenue from Rental of Electric Property</td>
<td>28,623,000</td>
</tr>
<tr>
<td>d) Meralco Subsidy</td>
<td>3,383,047</td>
</tr>
<tr>
<td>e) January 1995 Loss on System Loss Capacity</td>
<td>35,655,411</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>P 44,315,950,643</td>
</tr>
</tbody>
</table>

In many discussions between the findings of COA and the counterclaims of Meralco on operating revenue, the Board found it more reasonable to adopt the arguments of Meralco. To wit (see Table 10):

Table 10. The Deliberation of ERB on the Issue of Operating Revenue of Case 93-118: COA Audit Findings vs. Meralco Counter-Claims

<table>
<thead>
<tr>
<th>Operating Revenue Item</th>
<th>COA Audit Finding</th>
<th>Meralco Counter Claim</th>
<th>ERB Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior Years Electric Bill</td>
<td>Adjustment of any item in profit and loss pertaining to prior periods should be excluded from the determination of the net income for the current period. Therefore, this should be reflected in the Retained Earnings account. Nominal accounts affected should also be charged to Retained Earnings account for rate fixing purposes</td>
<td>Transactions of this nature occur regularly every month and are recorded in Journal Vouchers regardless of billing dates. It is observing the clean surplus theory or the all inclusive concepts, wherein all prior years adjustments affecting revenues and expenses are considered as current adjustment</td>
<td>Recurring transactions in the period adjustments were made should be treated as prior period adjustments since these happen with regularity (adopting Meralco’s argument)</td>
</tr>
<tr>
<td>Estimated Gain in System Loss (SL) Capacity</td>
<td>The gain from system loss capacity should be treated as an</td>
<td>This should be treated as part of its revenue since the firm is obligated to</td>
<td>The Generation Charge of the firm is for the purpose of</td>
</tr>
</tbody>
</table>
extraordinary item and not as a reduction to current revenue. At that time, Meralco deducted some P96.6M from the current operating revenue, on the theory that the cost of power based on the allowed 15% SL capacity was greater than the actual cost of power purchased. Meralco should have refunded this to its customers, as it did in March 1995. The amount of refund could only be determined at the end of the year when the total cost of electricity adjusted to the SL cap and company use is compared with actual cost of power purchased. COA should also have included the January 1995 SL as its audit was from February 1994-January 1995. Action was merely a result of NPC directives and said subsidy decreased Meralco’s revenue. Rental from use of electric property should be included as part of normal operating revenues. (favoring Meralco’s arguments)

<table>
<thead>
<tr>
<th>Subsidy to Various Customers and other Electric Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>The subsidy given by Meralco on the demand charges partakes the nature of a discount in the customers’ bill. Therefore, the burden of subsidy to selected customers should not be passed on to the consuming public. Said discount was given in order to alleviate the power deficiency in 1993 and 1994. This was in accordance with the NPC Board’s approved Resolution, covering NPC and Meralco customers to run their standby Gensets with a grant of incentives from the firm amounting to P25/kWh generated.</td>
</tr>
</tbody>
</table>


Operating Expenses

Meralco claimed that its operating expenses for rate making amounted to P40,605,997,000. COA on its audit report, however, maintained that it was only P38,162,503,175. The difference between the two figures is P2,443,493,825, which consists of the following items disallowed by COA (Table 11):

A big chunk (P2.135B of P2.443B or almost 90%) of the total disallowed operating expenses was on the provision of income tax. As earlier noted, COA adopted the view “that by the very nature of income taxes, the same should be borne by the stockholders...instead of passing over to the rate payers the burden of paying the income tax.”[65] Thus, in conducting the audit, COA had considered all taxes as recoverable from consumers, except for income tax.

COA further observed that “other corporations doing business are not regulated as in the case of public utilities, yet they compete to gain profits, and are subjected to payment of income taxes. On the other hand, public utility companies are authorized to monopolize business in certain areas and are assured of a rate of return (or income) based on appraised value of property. Why then should it
(Meralco) be exempted from paying income tax by passing it over to its customers?“[66]

Table 11. Total Disallowed Meralco Expense per COA Report

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchased Power</td>
<td>P 46,826,452</td>
</tr>
<tr>
<td>Operations</td>
<td>187,889,844</td>
</tr>
<tr>
<td>Maintenance</td>
<td>28,542,446</td>
</tr>
<tr>
<td>Depreciation At Cost</td>
<td>30,656,526</td>
</tr>
<tr>
<td>Appraisal Increase</td>
<td>4,074,087</td>
</tr>
<tr>
<td>Taxes Other Than Income Tax</td>
<td>9,865,470</td>
</tr>
<tr>
<td>Provision for Income Tax</td>
<td>2,135,639,000</td>
</tr>
<tr>
<td>Total Disallowed Expense per COA Report</td>
<td>P 2,443,493,825</td>
</tr>
</tbody>
</table>

Meralco, on the other hand, disagreed with this COA stand and argued that for ratemaking purposes, income tax should be treated as operating expenses. It explained that before 1986, it had not been subject to income tax by virtue of its franchise, but later subjected to it by virtue of EO 72 as cited earlier.

The ERB, however, concurred with COA’s position on this matter. Likewise, the Board opined that “the income tax, being a DIRECT tax on Meralco, could not be passed on the utility’s customers. Every taxpayer who is required under law to pay the income tax pays the tax himself and does not shift the burden to another. Meralco should be no exception, or any utility for that matter, in shifting the burden of paying the income tax. The latter is rightfully a tax on the income of the stockholders that compose the company and not to customers who are already burdened in paying...”[68]

Rate of Return (RORB)

The Board thence concluded its findings and computed the RORB of Meralco. Considering the above assessments and premises, it found the firm’s RORB to be about 20.15%, some 8% more than the authorized RORB of 12%, for the period beginning February 1994-January 1995. The breakdown is as follows (Table 12):

Table 12. ERB’s Computation of Meralco’s RORB

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>At Appraised Value (In Thousand Pesos)</td>
<td></td>
</tr>
<tr>
<td>Total Invested Capital Entitled to Return</td>
<td>P30,059,614</td>
</tr>
<tr>
<td>12% Return Thereon</td>
<td>P 3,607,154</td>
</tr>
<tr>
<td>Add: Total Operating Expenses for Rate Determination Purposes</td>
<td>38,260,420</td>
</tr>
<tr>
<td>Computed Revenue</td>
<td>P41,867,573</td>
</tr>
<tr>
<td>Actual Revenue</td>
<td>44,315,951</td>
</tr>
<tr>
<td>Excess Revenue</td>
<td>P 2,448,378</td>
</tr>
</tbody>
</table>
Percent of Computed Revenue to Actual Revenue 94.48%
Percent of Excess Revenue to Actual Revenue 5.52%
Percent of Excess Revenue to Invested Capital 8.15%
Authorized Rate of Return 12%
Actual Rate of Return 20.15%
Total kWh Sold 14,640,094,000
Ratio of Excess Revenue to Total kWh Sold P0.167

Source: ERB Decision of 1998, p.59

Decision of February 16, 1998

Wherefore, premises considered, and after almost five long years of public hearings, deliberations, inspections, audit and assessments, the ERB came up with the following decision:

The Board hereby authorizes applicant Manila Electric Company to adopt and implement a rate adjustment in the average amount of P0.017 per kWh, effective with respect to the applicant’s billing cycles beginning February 1994. Accordingly, the provisional relief in the amount of P0.184 per kWh granted under the Board’s Order dated January 28, 1994 is hereby superseded and modified and the excess average amount of P0.167 per kWh starting with the applicant’s billing cycles beginning February 1994 until February 1998, be refunded to applicant’s customers or correspondingly credited in their favor for future consumption...

Thus, the ERB of 1998 rescinded the Board’s 1994 Decision. It found out that Meralco was indeed entitled to a rate increase, but to a lesser amount. A refund or a credit to their customers’ future consumption was consequently ordered, effective the billing cycles from February 1994 to February 1998. The amount of an average of P0.167 per kWh represents an “excess” from the amount of rate adjustment (increase) provisionally granted in 1994, e.g., P0.184 and the amount that it should have been actually granted, e.g., P0.017.

7. Meralco’s Recourse and Petition for Review Before the Court of Appeals and the CA 1999 Ruling

The Meralco Petition Before the Court of Appeals
The ERB Ruling of 1998 has significant negative financial implications to Meralco to the tune of some P11-P30 billion. Thus the firm filed a Petition for Review, with application for Temporary Restraining Order and/or Writ of Preliminary Injunction, with the Court of Appeals (CA) on February 23, 1998. This was a full week after the 1998 ERB decision.

The Meralco petition addressed as respondents, the ERB, several individuals and institutions that were against Meralco’s 1993 petition for rate increase, and the COA. It recited the arguments for and premises of the 1993 petition (ERB Case 93-118), the 1994 provisional authority granted to it by ERB, other developments, the COA Report, and the 1998 ERB decision reversing the 1994 provisional grant and ordering the firm to refund to its customers some P0.167 per kWh of ‘excess’ charge from February 1994-February 1998.

Meralco also stated the issues involved in its petition with the CA, to wit:

1. In the determination of a fair rate of return, is income tax payment included as part of operating expenses?
2. In computing the rate base for the ROR determination, is the use of Meralco of the average investment method proper?
3. Was Meralco denied procedural due process by the display of bias and prejudice by members of the ERB when they announced to the media the overcharging claimed by them, even while they were still deliberating on the case?
4. Assuming the outlandish doctrines adopted by ERB are legally acceptable, can they be given retroactive effect?[70]

In connection with these issues, the distribution utility argued and alleged that

1. The ERB disregarded basic legal principles.
Meralco alleged that the regulator disregarded certain basic principles in Public Utility Law, particularly in rate making. These are:

   a. A public utility is entitled to a fair return on rate base or a return based on an income upon its property.[71] Rates, which are not sufficient to yield a fair or reasonable return on the value of the property being used to render public service, are confiscatory and their enforcement deprives the public utility of its property in violation of the Constitution.[72]

   b. In determining the sufficiency of the return, the sum that is required by the public utility to meet its operating expenses must be considered, including its income tax payments.[73]

   c. In computing the rate base for rate fixing purposes, the accepted rule is the averaging method, that is, the sum of the beginning and ending values divided by two.[74] This is the method used by Meralco.[75]
2. **In disallowing income tax as part of the operating expenses, the ERB disregarded judicial and administrative rulings, including its own decisions.**

According to Meralco, the ERB 1998 ruling disallowing income tax amounting to P2.135B as part of the firm’s operating expenses was erroneously based on a PSC decision, which was set aside by the Supreme Court. Said PSC Case (nos. 85889, 85890 and 89893) in 1957 was questioned by Meralco in 1964 before the Supreme Court, which found-

“...We have gone over the merits and demerits of the essays and beautiful theories advanced by the respondents (PSC, COA et al.). But the cold fact remains, after a panoramic perusal of the record and circumstances surrounding these cases that the petitioner had not been given its day in court...

WHEREFORE, we set aside the decision of the Public Service Commission of December 27, 1957 and the order of March 3, 1958, and remand the records of the above entitled case to the Commission for further proceedings, and to render judgment accordingly.”

As such, according to Meralco, the PSC decision invoked by ERB and COA never gained any force and effect and their adherence to such was misplaced. Therefore, COA and ERB should be castigated since they made gross misrepresentation by citing as main support to their decisions, a ruling of an administrative body (PSC) that had been set aside by the Supreme Court. Their “act of irresponsibility” should be explained because they gave false hopes not only to the customers of Meralco but to the customers of all public utilities (electric, transportation, shipping, telephone, etc.)

Meralco also maintained that the prevailing rule is that income tax is allowed as part of the operating expense. This is so, according to the ERB Decision of 1998, p. 59. In addition, prior to the 1998 Decision, the ERB has consistently allowed public utilities to include income tax payments as part of their operating expenses, as attested to by the Cotabato Light and Power Case decision cited earlier and another case (San Fernando Light). Meralco also pointed out that one ERB member (Hon. Melinda L. Ocampo), who signed the 1998 decision, also signed the earlier ERB decisions allowing income tax as an operating expense.

3. **In rejecting the average investment method, the COA and the ERB contravened Supreme Court decisions, the PSC 1957 Decision, including its own decisions.**

Meralco also questioned the method used by COA in appraising its property. It said that the SC and the PSC have sustained the averaging method in several
occasions in the past and that the COA should not have questioned its use in the Meralco petition. In the case petitioned for review with the CA, it is worth noting that the ERB concurred with the proposal of Meralco to use the averaging as against the “preferred” method of COA. The latter assumes that a piece of property becomes part of the rate base, and hence entitled to return, only starting from the time it is placed in actual service.

4. **Meralco disputed other disallowances by the ERB and alleged that it was denied due process.**

Meralco reiterated its objections in some of the disallowances by ERB based on the 1997 COA Report. More importantly, it alleged that it was denied due process because “even while admitting that the ERB was still in the process of deliberating on the merits of the petitioner’s case (Meralco’s), some members of the ERB were already announcing in the tri-media that Meralco has been overcharging its customers.”

It provided a litany of what it believes as due process. Such (due process) “requires an impartial tribunal. A fair trial by an unbiased and non-partisan trier of facts is of the essence of the adjudicatory process. An administrative decision cannot stand if either of the hearing officers is infected with legal bias. One type of legal bias is prejudice. A decision tainted with prejudice must be set aside.”

Hence, it implicitly suggested setting aside the ERB 1998 decision, because the Board was bias. Recall that neither did Meralco raise a howl nor invoke this ethical principle in 1994, when the ERB Chair (and not merely a Member) was the one charged with bias and in fact “defending” Meralco, because the prejudice was in its favor.

Thus, Meralco prayed that the Court of Appeals issue a restraining order and a writ of preliminary injunction to prohibit ERB from implementing its 1998 Decision. It also asked the CA to render judgment setting aside the 1998 ERB Decision.

**Counter-Claims of the Respondents of the CA Case**

The registered oppositors of the Meralco petition with the CA were the TUCP, KMU, the Confederation of Concerned Organizations of Balut, Bagong Alyansang Makabayan (BAYAN), Lawyers Against Monopoly and Poverty (LAMP), Raul Concepcion, Philippine Exporters Confederation, Inc., Genaro Lualhati, Philippine Consumers Foundation and Cesar Escosa. From the documents gathered by this writer, it seems that the ERB registered its opposition and Motion to Resolve Motions for Reconsideration, only after the Court of Appeals rendered its 1999 Decision reversing its (ERB’s) 1998 Decision.
Of the above counter-claimants and oppositors to the Meralco petition, the ones significantly cited by the CA as part of the support to its decision included:

1. **Lualhati**, who said that the ERB’s order to refund P0.167 per kWh would not necessarily affect Meralco’s financial liability, considering that *this amount is not Meralco money but the amount that it has collected from February 1994, in excess of the 12% RORB as audited by COA. Also, the irreparable damage instead would impair the 3.7 million customers of the firm who had already paid electricity in excess of 10.5% that Meralco applied for (in 1993) and is even in excess of the 12% RORB. Passing the income tax to the customers is also an admission of tax evasion, which is a violation of the Internal Revenue Code. This is not to mention the fact that Meralco’s treatment of income tax as an operating expense is misleading... [86]

2. **LAMP**, that also said that under the Tax Reform Act of 1997, income tax is not an allowable deduction from the gross income of domestic corporations, and that this indeed is the intention of the law—*that a public utility like the petitioner pays income tax in addition to franchise tax...There is no Supreme Court ruling/jurisprudence that allows income tax as part of operating expenses; that the decision cited by the petitioner is simply based on American decisions which are not part of the Philippine Legal Doctrine. Hence, the ERB can “ignore or reverse” its own ruling on previous cases, if any or that ERB is free to make a decision on the basis of its own “best judgment.” [87]

3. **Escosa** said that Meralco presented “diversionary tactics,” not to mention the fact that the criminal and civil aspects of the case have not been “ventilated” as issues in the appeal [88]

**The 1999 Decision of the Court of Appeals**

The Court of Appeals disagreed with the contentions of the oppositors of the case. For example, with regard to the claim that the government is not estopped from correcting the errors of its agents, that the present Board is not bound by its previous rulings, and that US decisions are not necessarily binding in this jurisdiction, the CA argued that

“Our courts and regulatory agencies, to a large extent, have always followed and adopted American jurisprudence especially concerning rate regulation. The observation of Chief Justice Castro (Republic v. Medina, 41 SCRA 643) is still relevant. He said:

“This Court’s opportunity to articulate on the subject has necessarily been limited by the mere handful of cases that have come up for review
with the PSC. My study therefore perforce looks to and emphasizes American pronouncements. American courts and administrative bodies have had long and constant exposure to the various problems involved in rate-fixing, and their experience is certainly to be valued, within the context of our own legal and political systems.”

We naturally have no option but to resort to existing American jurisprudence, in the absence of local decisions dealing directly with the issue whether income tax should be treated as part of the operating expenses.”

The CA could not also share the view that by considering income tax as an operating expense, Meralco in effect would be passing the tax burden to the customers and thus would be exempt from income tax. It cited the ERB ruling on ERB Case 91-70:

“The ruling is the public utility still has to pay the taxes due; it is not exempt from the same. What the public utility is actually allowed to do is merely to recover from its customers no longer the tax due but technically the costs of expenditures it incurred in paying the taxes. A valid tax against the utility by the government constitutes an expense of operation in the exact amount of the taxes so assessed.”

By analogy, therefore, “income tax remains a burden of the petitioner and is not being passed on to the consumers. The amount, as added, becomes a part of the petitioner’s rate, but the tax still remains with the petitioner alone. Precisely because public utilities are subject to rate regulation, they are necessarily entitled to a reasonable rate of return. Disallowing income tax as part of the operating expenses, as pointed out by the petitioner, would necessarily reduce its effective rate of return...”

The CA also concurred with the averaging method used by Meralco, citing various rulings of the PSC. It also admonished the ERB “for changing rides in midstream, which is violative of the rule of stare decisis. This is the rule that rests on the desirability of having stability in the law...”

The foregoing considered, the Court of Appeals on February 24, 1999, a year after the ERB ordered Meralco to refund its customers by P0.167 per kWh,
rendered a judgment setting aside the contested ERB Decision of 1998. Categorically, it disposed of the Meralco petition as follows:

The FOREGOING CONSIDERED, judgment is hereby rendered, setting aside the contested Decision in so far as it directed reduction of the Meralco rates by an average of ₱0.167 per kWh, supposedly effective after February 1998; and its refund to the consumers starting with the billing cycle February 1994 until the billing cycle beginning February 1998.

SO ORDERED. [94]

It was penned by Bernardo Ll. Salas, Associate Justice and concurred by Associate Justices Consuelo Ynares-Santiago and Candido V. Rivera. Justice Ynares-Santiago was also the Chairperson of the Special 12th Division of the Court of Appeals. [95] She is now a Justice of the Supreme Court.

ERB’s Motion for Reconsideration

The 1998 ERB[9], together with the other oppositors to the Meralco petition, later (on March 18, 1999) filed a Motion for Reconsideration with the CA. It prayed that the CA reconsiders its decision of February 1999 and dismiss Meralco’s petition for lack of merit.

It also asked why the Court of Appeals did not discuss the merits of the disallowance it made on the case, yet the CA completely overruled its Decision. Likewise, it argued that the disallowances it decided on were proper based on the fundamental rule in rate making that only properties and equipment necessary, useful, and actually used in service to the utility’s customers are entitled to a rate of return. [96]

More specifically, the Board argued that:

1. The contention of Meralco that income tax should be allowed as an operating expense is not in accordance with the law. To wit:

   “The Board concurs with COA’s position that by its very nature, income tax should be borne by stockholders who are recipients of the income or profits realized from the operation of their business instead of passing over to the rate payers the burden of paying the income tax by allowing it as an operating expense...” [97]
According to ERB, this rule settles who bears the burden as taxes are classified into direct and indirect taxes. Direct taxes, such as corporate and individual income taxes, are taxes demanded from the person who also bears the burden of the tax or taxes for which the taxpayer is directly liable. The taxpayer cannot shift this burden to another. On the other hand, indirect taxes such as value-added taxes and custom duties are taxes demanded from one person who shifts the burden to the ultimate purchaser.\[98\]

EO 72, ERB continued, “does not make a distinction between public utilities and other corporations in respect to the treatment of income taxes. In fact, under this Executive Order, electric utilities are assessed 2% of its gross receipts as franchise tax while other franchises are assessed 5%. There is no showing that the intention of EO 72 was that the burden of paying income tax should be borne by the consumers. It should be remembered that an income tax is a tax on the income itself. Therefore, the entity which is earning the income is the proper entity to bear the burden of paying income tax.”\[99\]

ERB also cited Section 29 (c) of the National Internal Revenue Code of 1979, as amended, which provides that:

“In general- taxes paid or incurred within the taxable year in connection with the taxpayer’s profession, trade or business, shall be allowed as deduction from gross income except the income tax provided for under this Title...”\[100\]

Thus, under this Code, income tax is not an expense in the course of the operation of trade or business, or in this case, of the operation of electricity. It cannot be considered as operating expense. Consequently, it cannot be included as deduction in the computation of the rate base.\[101\]

In addition, according to ERB, the petitioner’s contention that disallowing income tax as part of operating expenses would necessarily reduce its effective rate of return is misleading. This is because Meralco has been continually appraising its properties.\[102\]

The ERB also defended COA, which it believes had been consistent in disallowing income tax as operating expense. “The determination of the COA is entitled to great faith and credit.” \[103\]

Moreover, the issue of whether income tax should be part of operating expenses or not has been settled as early as June 14, 1955 by the then Public Service Commission. In PSC Case 2981 filed then by Philippine Power & Development Co., the PSC ruled that “income taxes should not be allowed
as an operating expense for the purpose of determining just and reasonable rates.”[104]

This doctrine was affirmed by PSC on December 27, 1957 in PSC Cases 85889, 85890, and 89893. This was set aside by the Supreme Court, as intimated by Meralco, “not because the PSC made an erroneous conclusion in excluding income tax from the operating expenses but because the petitioner was not given a day in court. When the cases were remanded by the SC to the PSC, Meralco moved to withdraw its petitions and its motion was approved (18 SCRA 651).”[105]

The ERB argued that the SC order setting aside the PSC decision of 1957 does not invalidate the accepted principle contained therein, that income tax “should be borne by stockholders who are the recipients of the income or profits realized from the operation of their business.”[106]

ERB also said that the cases filed by Cotabato Light and San Fernando Electric were not analogous cases to Meralco’s application, and that there was no point of comparison. In the earlier cases, the ERB authorized the applicants to refund income taxes already paid by the electric utilities to the government through tax recovery clauses. In Meralco’s case, it charged first their consumers based on the estimate of income tax to be paid and later on paid the actual income tax to the government.[107]

Assuming for the sake of argument that ERB had allowed Meralco and other utilities to treat income tax as operating expense in the past. ERB however believed that such was immaterial to the case since “the government is not estopped from correcting the errors of its agents. Adherence to precedence for precedence’s sake is not a wise policy. More important than anything else is that ERB should be right. The present ERB (1998) is not bound by previous erroneous rulings. As a rule, no vested rights can be acquired in rate making since it depends on the circumstances and conditions prevailing.”[108]

To the ERB, more important than adherence to previous decisions is the fulfillment of its mandate to prescribe rates which are just and fair to both the utility and its consumers.[109]

2. The American decisions, which allow public utilities to treat income taxes as operating expenses, are inapplicable here.[110]
For one, almost all US Regulatory Commissions adopt the original cost or historical cost methods in the determination of the rate base. The
Philippines meanwhile uses the reproduction cost method (RCND) in determining the rate base. In the case of Meralco, its total assets in 1994 would amount to P16.5 billion at historical cost and P24.1 billion using RCND. The CA in its 1999 decision overlooked this significant difference.  

Also, in the case of the allowance of working capital as component of the rate base, the US Regulatory Commissions allow only one and a half months, while in the Philippines, two months working capital is allowed as component of the rate base.

Thus, the ERB admonished CA that foreign jurisprudence should not be unqualifiedly invoked without taking note of the circumstances surrounding those cases decided by foreign courts. As held by the Supreme Court in Republic vs. Medina, 41 SCRA 643, the experience of American courts and administrative bodies should be valued “within the context of our own legal and political systems.” In his concurring opinion, Justice Castro stated that “(w)e do not expect to follow and observe American techniques and principles all the way; differences do exist between our respective jurisdictions...”

3. Meralco was given a fair rate of return

According to the “end result doctrine”, the bottom line in rate determination is whether the rates prescribed are just and reasonable to both the public utility and the consumers. As held in Republic vs. Medina, 41 SCRA 644:

“The decided weight of authority, however, is to effect that property valuation is not to be solved by formula, but depends upon particular circumstances and relevant facts affecting each utility as to what constitutes a just rate base, and what would be a fair return, just to both the utility and the public.”

The ERB believed it allowed and disallowed certain items in the Meralco appraisals and ordered a refund in 1998, because it adhered to the well settled principle in rate making “that only property used, useful and necessary in rendering service to the utility’s patrons or customers are entitled to a rate of return.”

Based on the arguments above, the ERB prayed that the Court of Appeals reconsider its decision of February 1999. The Office of the Solicitor General (OSG), the government agency mandated to defend and promote the interest of the government and its agencies, prepared the ERB petition. Ricardo Galvez, then Solicitor General; Nestor Ballacillo, then Assistant Solicitor General; and Associate Solicitors, Tomas Navarro and Fidel Thaddeus Borja penned this Petition.
After considering their arguments and opposition, the Former 12th Division of the Court of Appeals on December 23, 1999 again denied all their motions for lack of merit.\[115\] The CA resolution reads:

“After considering petitioner’s Opposition (Rollo, p. 1675), petitioner’s opposition, (Ibid. p. 1715), the petitioner’s comment, (Ibid., p. 1750, 1770), the 1) ERB’s Motion for Reconsideration, 2) Lualhati’s Motion for Reconsideration, 3) Lualhati’s Urgent Motion to Strike, 4) Lualhati’s Reiteration of Urgent Motion to Strike, and the Ex-parte Motion for Reconsideration by Escosa, are all hereby denied, for lack of merit.

So ordered.”\[116\]

The following Associate Justices of the Court of Appeals signed this Resolution: Bernardo Salas, Candido Rivera and Presbitero Velasco, Jr. Justices Salas and Rivera were original members of the 12th Division. As earlier noted, the Chair of the former 12th Division of the CA, which rendered the February 24, 1999 decision, Justice Ynares-Santiago, is now a Justice of the Supreme Court.

8. **ERB’s Appeal to the Supreme Court of the Philippines**

In a sixty-one-page Petition, the ERB through the OSG filed on February 23, 2000 an appeal with the Supreme Court. It prayed that the SC nullifies and sets aside the CA Decision of February 24, 1999 and the CA Resolution of December 23, 1999. It also moved that its (ERB) Decision of February 16, 1998 be reinstated.

In layman’s term, it asks that the SC to reverse the 1999 CA decision and resolution. Corollary, it hopes that the SC affirms the ERB Decision of 1998 ordering Meralco to refund its customers.

The ERB retold the evolution of the ERB Case 93-117 from 1993 to 1999. It then asserted that the Court of Appeals, in reversing its 1998 decision, gravely erred and decided a question of substance not heretofore determined by the CA. In addition, the CA

1) Declared it in a way not in accord with law when it held that income tax should be treated as part of operating expense;

2) Decided it in a way not in accord with law when it rejected the net average investment method or the actual number of months method used by COA and adopted by the ERB; and
3) Gravely erred when it did not deal on the merits of the disallowance made by the ERB and contested by Meralco, and yet it completely overruled the decision of ERB.[117]

It explained that it had no recourse other than the SC petition, “where it raised substantial issues affecting not only Meralco and the electric service providers but also those belonging to other public services like water, telecommunications and transportation...The definitive doctrines or rules to be laid down by the SC are decisive for the guidance of all concerned.”[118]

The ERB reasoned with the Supreme Court, based on the following justifications:

1. The Court of Appeals Gravely Erred and Decided a Question of Substance Not Heretofore Determined by This Honorable Court (CA)

   The ERB emphasized that it is the government agency with the exclusive jurisdiction of prescribing rates for electric utilities. As such, “its findings and rulings carry great weight, even finality, and should be binding on the courts, in the absence of grave abuse of discretion. Rate fixing involves a series of technical operations into the details of which the Courts are ill-equipped to enter, and which is primarily entrusted to the Public Service Commission (and later ERB in this case).”[119]

   Moreover, it argued that the rule that factual findings of administrative agencies are accorded not only respect but also finality is already a settled issue. This is so because “of the special knowledge and expertise gained by these quasi-judicial tribunals from handling specific matters falling under their jurisdiction. Their findings of fact must be respected so long as they are supported by substantial evidence.”[120]

   Quasi-judicial bodies have the acknowledged expertise in the fields of specialization to which they are assigned. Likewise, even the courts of justice are concluded by such findings in the absence of a clear showing of grave abuse of discretion.[121]

   More importantly, according to ERB, “Meralco was not able to demonstrate that the ERB committed grave abuse of discretion in rendering its Decision of February 16, 1998.”[122]

   In addition, in the opinion of the ERB, Meralco was given a fair return and due consideration of its causes and interests. It was given due process and
allowed to explain, rebut, comment, critique and file its counter-arguments and claims.[123]

2. The Court of Appeals Gravely Erred and Decided a Question of Substance Not Heretofore Determined by This Honorable Court (CA) and Declared it in a Way Not in Accord with Law when it held

a) That Income Tax Should be Treated as Part of Operating Expense

The ERB reiterated the arguments it presented to the Court of Appeals. [s]It held that “income tax, being a direct tax[1] on Meralco, is a burden that Meralco cannot shift to its customers.”[124]

It distinguished direct and indirect taxes: A direct tax is a tax for which a taxpayer is directly liable on the transaction or business it engages in. An indirect tax is primarily paid by persons who can shift the burden upon someone else.[125] Examples of direct taxes are corporate and individual income taxes, community (formerly residence) tax, estate tax, and donor’s tax. Examples of indirect taxes are value-added tax, excise taxes on certain specific goods, customs duties[126]

The ERB also restated its contention that “American decisions allowing public utilities to treat income tax as operating expense are inapplicable here.”[127] For one, almost all US Regulatory Commissions adopt the original cost or historical cost methods in the determination of the rate base. Meanwhile, the Philippines uses the reproduction cost new method (RCNM). In the case of Meralco, its total assets in 1994 would amount to only P16.4B at historical cost and P24.2B using the RCND. This is a significant difference, which the CA overlooked.[128]

Even if Meralco is not allowed to treat income tax as operating expense, unlike US public utilities, still, according to ERB, “the firm is compensated by the fact that its rate base, as determined by Philippine practice, is much higher than when it is determined using US regulatory practice.”[129]

Another reason why US decisions cited by the CA are not applicable here is that “investor-owned public utilities in the US have been singled out for special taxation or that they are subjected to one or more taxes that are not levied upon other industries. American utilities generally pay six types of taxes, e.g.:

1) Ad valorem or property tax-paid on the value of the utility’s assets; 2) Gross receipt taxes- a percentage of gross income or receipt; 3) Income tax- a percentage of net income; federal income tax plus state income tax;
4) Excise tax;
5) Franchise tax; and
6) Social Security taxes.\[130\]

US electric utilities pay a disproportionately large share of their gross income as tax payable to the government. Income tax expenses amount to approximately 52% of the company’s net income. Ironically, other businesses and industries do not share this tax burden. Likewise, the huge tax payment of 52% is much higher than the 35% rate of income tax imposed on domestic corporations in the Philippines.\[131\]

b) When It rejected the Net Average Investment Method or Actual Number of Months Method Used by COA and Adopted by the ERB

In its decision of February 24, 1999, the Court of Appeals held:

“This brings us to the case of Republic vs. Medina, 41 SCRA 644, in which the petitioner used as a basis for property valuation, the “trending method,” or the method of giving recognition to changing economic conditions and advantages in the purchasing power of the currency from the time of investment and the time of the rate base computation. The (Supreme) Court said that the trend factor in reevaluating petitioner’s property cannot be said to have resulted in the over valuation of the utility plant in service. As a matter of fact, it accepted the decision of PSC when the latter adopted the “average book value” for a given year..."\[132\]

According to the ERB, what the court took into consideration, as a typical item was the gross book value for the period ending December 31, 1968 and 1967, and not the actual number of months a property has been in service or the net investment method, which the PSC and the SC had affirmed in the case of Manila Electric Company vs. PSC, 18 SCRA 651. In the latter,

“The PSC has adopted the present or market value theory, xxx as well as the method of valuation used and the appraisal made by the same, after making therefrom some deductions recommended by GAO..."\[133\]

The National Accounting and Auditing Manual and the Audit Notes on Public Utilities also prescribe the use of the net average investment method. Thus, ERB contended, it couldn’t be said that COA changed rules in midstream.
In addition, there was no violation of the rule of *stare decisis* since in the Supreme Court cases cited by the Court of Appeals, there was no issue on the proper method to be used in the determination of the rate base. Therefore, it cannot be said that there already exists an established doctrine on the proper method of determining the rate base, which would be discontinued or destabilized by new decisions.

3. *The Court of Appeals Gravely Erred When It Did Not Deal on the Merits of the Disallowance Made by the ERB and Contested by Meralco and Yet It Completely Overruled the Decision of the ERB*

The ERB believed that the CA erred in its assumptions and substitution of its own decision with that of the ERB. In its resolution of December 23, 1999, the Court of Appeals held:

We agree with the petitioner (Meralco) thus:

It is true that the COA recommended that certain assets of Meralco, listed in SAO Report No. 95-07, should be excluded in the rate base because they are not used and useful in the rendering of service to the public. The ERB accepted some of the recommendations and rejected others, either totally or partially. The disallowances that the ERB accepted are relatively minor. In addition, the ERB did not even state, in the event of a reversal of the (1994 ERB) ruling, that the petitioner’s RORB still exceeded the allowed level. The ERB also did not indicate either how much the refund would be...

In disregarding the disallowances from the rate base of some Meralco property, this Honorable Court (CA) applied the *de minimis* rule, a very practical tool, that the Courts should not waste their time and energy in dealing with trifles that will not affect one way or the other the results of the case.

The ERB argued that the CA decision was without basis and referred the Supreme Court to its sixty four-page Decision of February 16, 1998.

9. *The 2002 Decision of the Third Division of the Supreme Court*

After almost four years of hearings and deliberation, the Third Division of the Supreme Court decided on November 15, 2002, the following:

WHEREFORE, in view of the foregoing, the instant petitions are GRANTED and the decision of the Court of Appeals in C.A. G.R. SP No. 46888 is REVERSED.
Respondent Meralco is authorized to adopt a rate adjustment in the amount of P0.017 per kWh, effective with respect to Meralco’s billing cycles beginning February 1994. Further, in accordance with the decision of the ERB dated February 16, 1998, excess average amount of P0.167 per kWh starting with the applicant’s billing cycles beginning February 1994 is ordered to be refunded to Meralco’s customers or correspondingly credited in their favor for future consumption.

SO ORDERED.\[136\]

This SC decision was premised on the following grounds:

1) Should Public Interest Prevail upon Private Profit?

As penned by Justice Reynato S. Puno, “the case at bar is of utmost significance for it concerns the right of the people to electricity and to be reasonably charged for their consumption. In configuring the contours of this economic right to a basic necessity of life, the Court shall define the limits of the power of Meralco, a giant public utility and a monopoly, to charge our people for their electric consumption. In third world countries like the Philippines, equal justice will have a synthetic ring unless the economic rights of the people, especially the poor, are protected with the same resoluteness as their right to liberty. Thus, the question is: should public interest prevail over private profits?”\[137\]

The SC decision agreed that indeed, public interest should prevail. It explained:

The regulation of rates (to be charged by public utilities) is founded upon the police powers of the State and statutes prescribing rules for the control and regulation of public utilities are valid exercise thereof. When private property is used for a public purpose and is affected with public interest, it ceases to be juris privati only and becomes subject to regulation. The regulation is to promote the common good.

In regulating rates, the State protects the public against arbitrary and excessive rates while maintaining the efficiency and quality of services rendered. However, this power does not give the State the right to prescribe rates, which are so low so as to deprive the public utility of a reasonable return on investment. Thus, “the rates prescribed by the State must be one that yields a fair return on the public utility upon the value of the property performing the service and one that is reasonable to the public
for services rendered. The fixing of rates involves balancing of investor and consumer interests.^[138]

...When a public utility is entitled to a reasonable rate of return on the fair value of the property being used for the service of the public, “the public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends...”^[139]

2) The ERB has substantive jurisdiction on the case and that no abuse of discretion was evident.

According to the Supreme Court, “what is just and reasonable rate is a question of fact^[w] calling for the exercise of discretion, good sense, and a fair, enlightened and independent judgment (of administrative bodies). The requirement of reasonableness comprehends such rates, which must not be too low as to be confiscatory, or too high as to be oppressive. “In determining whether a rate is confiscatory, it is essential also to consider the given situation, requirements and opportunities^[140] of the utility.”^[141]

Settled jurisprudence holds that factual findings of administrative bodies on technical matters within their area of expertise should be accorded not only respect but even finality if they are supported by substantial evidence even if not overwhelming or preponderant^[142] In one case,[143] we cautioned the courts to “refrain from substituting their discretion on the weight of evidence for the discretion of the PSC on questions of fact and only reverse or modify such orders of the PSC when it really appears that the evidence is insufficient to support their conclusions.”^[144]

The Court thus opined:[145]

In the case at bar, the findings and conclusions of the ERB on the rate that can be charged by Meralco to the public, should be respected. The function of the court, in exercising its power of judicial review, is to determine whether under the facts and circumstances, the final order entered by the administrative agency is unlawful or unreasonable^[146] Thus, to the extent that the administrative agency has not been arbitrary or capricious in the exercise of its power, the time-honored principle is that the courts should not interfere. The principle of separation of powers dictates that courts should hesitate to review the acts of administrative officers except in clear cases of grave abuse of discretion.[147]
In addition, the Supreme Court acquiesced that “Meralco has not adequately shown that the rates prescribed by the ERB were unjust or confiscatory as to deprive its stockholders a reasonable return on investment. In an early case of Ynchausti S.S. Co. vs. Public Utility Commissioner, this Court held: “(t)here is a legal presumption that the rates fixed by an administrative body are reasonable, and it must be conceded that the fixing of rates by the Government, through its authorized agents, involves the exercise of reasonable discretion, and unless there is abuse of that discretion, the courts will not interfere.” [148].”

The Court continued, “The burden to prove abuse of discretion is upon the oppositor, Meralco. In this case, it was unable to discharge this burden.”[149]

3) With regard to Rate-Determination, the Government is not hidebound to apply any particular method or formula. In addition, We Cannot Blindly Apply the Rulings of American Courts

Meralco insists that the Court should sustain the trending method in view of previous decisions of the Public Service Commission and of this Court which “upheld” the use of this method. By refusing to adopt the trending method, Meralco argues that the ERB violated the rule of stare decisis. [150]

The Court however believes, that in rate regulation, “what is just and reasonable cannot be fixed by any immutable method or formula. Hence, it has been held that no public utility has a vested right to any particular method of valuation. [151]

Accordingly, with respect to a determination of the proper method to be used in the valuation of property and equipment used by a public utility for rate making purposes, the administrative agency is not bound to apply any one particular formula or method, simply because the same method has been previously used and applied. In fact, nowhere in the previous decisions cited by Meralco which applied the trending method did the Court rule that the same should be the only method to be applied in all instances.”[152]

In addition, the Court could not give in to the importuning of Meralco “that we blindly apply the rulings of American courts on the treatment of income tax as operating expenses. An indiscriminate inclusion of such expense may create undesirable precedents and serve as a blanket authority for public utilities to charge their income tax payments as operating expenses and unjustly shift the tax burden to the customer.” [153]

The Court continued:
“To be sure, public utility taxation in the United States is going through the eye of criticism. Some commentators are of the view that by allowing the public utility to collect its income tax payment from its customers, a form of “sales tax” is, in effect, imposed on the public for consumption of public utility services. By charging their income tax payments to their customers, public utilities virtually become “tax collectors” rather than taxpayers.”[154] In the case at bar, Meralco has not justified why its income tax should be treated as an operating expense to enable it to derive a fair return for its services.”[155]

It is also noteworthy that the Court observed that:

“Under American laws, public utilities are taxed differently from other types of corporations and thus carry a heavier tax burden. Moreover, different types of taxes, charges, tolls or fees are assessed on public utilities depending on the state or locality where they operate. In contrast, in the Philippines, public utilities are subject to the same tax treatment as any other corporation and local taxes paid to local government units are substantially the same. The reason for this is that the power to tax resides in our Legislature unlike the federal system in America where state legislatures may prescribe taxes to be levied in their respective jurisdictions.”[156]

4. The Decisions of the ERB Not to Allow Income Tax as Operating Expense for Rate Determination, and Use the Net Average Investment Method are Fair and Not Unreasonable

The Court assessed that “at any rate, Meralco has not adequately shown that the rates prescribed by ERB are unjust and confiscatory.”[157]

In addition, the ERB correctly ruled that income tax should not be included in the computation of operating expenses of a public utility. Income tax paid by a public utility is inconsistent with the nature of operating expenses. In general, operating expenses are those which are reasonably incurred in connection with business operations to yield revenue or income. They are items of expenses, which contribute to the production of income or revenue. As correctly put by the ERB, operating expenses “should be a requisite of or necessary in the operation of a utility, recurring, and that it redounds to the service or benefit of customers.”[158]

Income tax should be borne by the taxpayer alone and not passed on to consumers “as they are payments in exchange for benefits received by the taxpayer from the state. Accordingly, the burden of paying income tax should be borne by Meralco alone and not be shifted to the consumers by including the same in the computation of its operating expenses,” the court ruled.[159]
Allowing Meralco, a company insulated from competition, to pass on the tax burden to consumers is unfair to companies that face competition but are subject to income tax.

Moreover, the ERB did not abuse its discretion when it applied the net average investment method. This treatment is consistent with the settled rule that the determination of the rate base that a public utility entitled to a return must be based on properties and equipment actually being used or are useful to the operations of the public utility.[160]

With all the above premises and evaluation of the “brief and undisputed facts”[161] about the case at bar, the Third Division of the Supreme Court granted the petition of the ERB on November 2002 and April 2003. It reaffirmed and upheld the 1998 ERB decision that ordered
1) the adjustment of the rate increase awarded to Meralco in 1994 to a lesser amount (P0.017 as against P0.184 provisionally granted in 1994), and
2) the refund or credit to future consumption of customers, of the excess average amount of P0.167 per kWh (P0.184-P0.017) starting the billing cycle of February 1994.

Corollary, it reversed or overturned the 1999 resolution of the Court of Appeals.

The last Ruling (April 9, 30, 2003) ends Meralco’s bid to avoid refund and was based on Section 2, Rule 52 of the 1997 Rules of Civil Procedure, which forbade the Court from considering a second motion for reconsideration of a judgment or final reconsideration. It also stemmed from the High Court’s affirmation of the ERB (1998) judgment that Meralco collected more than it should.[162] In addition, the Third Division ruled:

“Public utilities cannot be allowed to overcharge at the expense of the public and worse, they cannot complain that they are not overcharging enough.”

It also averred that:

“The business and operations of a public utility are imbued with public interest. In the very real sense, a public utility is engaged in public service providing basic commodities and services indispensable to the interest of the general public. For this reason, a public utility submits to the regulation of government authorities and surrenders certain business prerogatives, including the amount of rates that may be charged by it. It is the imperative duty of the State to interpose its protective power whenever too much profit becomes the priority of public utilities.”[163]
“To grant Meralco’s prayer would in effect allow the firm the benefit of a year by year adjustment of rates not normally enjoyed by any other public utility...

With or without income tax as an operating expense, Meralco would still enjoy excess revenue above the authorized rate of return of 12%.”[164]

Thus, the April 2003 SC decision became final and executory. Meralco must pay the refund. The high tribunal’s latest resolution means that the ERC and other agencies may proceed to implement the refund order.[165] Recall that proposals for the refund include a lump sum payment, conversion into shares of ownership in Meralco, immediate refund for small consumers, and credit against future consumption on a staggered basis.

C. FINDINGS AND INFERENCES

Using the narrow or more specific notion of regulation, the study gathered that regulation is a specific set of rules, decisions, orders, jurisprudence or actions that are legally binding on the regulated industry and the regulatory matter at hand.

Relative to the ERB Case 93-118, the specific regulatory rules, decisions, orders, jurisprudence or actions include the following:

1. The Supreme Court Decisions of 2002 and 2003, which stipulated among others, that
   a. When private property is used for public purpose and is affected with public interest, it ceases to be juris privati and becomes subject to regulation. The regulation is to promote the common good.
   b. In regulating rates, the State protects the public against arbitrary and excessive rates while maintaining the efficiency and quality of services rendered. Thus, the rates prescribed by the State must be one that yield a fair return on the public utility and one that is reasonable to the public. They should not be too low as to be confiscatory, or too high as to be oppressive.
   c. What is just and reasonable rate is a question of fact (as against question of law) calling for the exercise of discretion, good sense, and a fair, enlightened judgment of administrative bodies or regulators. Settled jurisprudence holds that factual findings of administrative bodies on technical matters within their area of expertise should be accorded not only respect but even finality… Courts are cautioned to refrain from substituting their discretion on the weight of evidence for the discretion of the regulators.
d. The government is not hidebound to apply any particular method or formula. It cannot also blindly apply the rulings of American courts because the Philippines and the United States have different contexts and processes.

e. The business and operations of a public utility are imbued with public interest. *In the very real sense, a public utility is engaged in public service providing basic commodities and services indispensable to the interest of the general public.* For this reason, a public utility submits to the regulation of government authorities and surrenders certain business prerogatives, including the amount of rates that may be charged by it. It is the imperative duty of the State to interpose its protective power whenever too much profit becomes the priority of public utilities…

2. The ERB Decision of 1998 which
   a. Reversed the 1994 Decision of the ERB granting provisional authority to Meralco to increase its rates
   b. Ruled that income tax should not be treated as part of the operating expenses
   c. Ruled that in valuing the assets in determining the reasonable return on rate base (RORB) of applicant firms, only properties which are *used and useful* to the operation of business are allowed or entitled to a rate of return
   d. Implemented the *conditional clause of all provisional authority*, which stipulates that if in the final analysis of the regulator (ERB), the applicant firm is entitled only to a lower increase, said firm should refund excess charges or credit the same to the customer’s future consumption.

These regulatory decisions, jurisprudence, actions and principles are binding on all applications for rate increases or on the assessment of the reasonable RORB of applicant firms. These are specifically binding on Meralco which in the final analysis was granted authority to increase its rates, but on a much lower rate, and ordered to refund excess charges to its consumers from the billing cycle of February 1994 to the present.

In addition, as can be inferred from the narration of the politics and dynamics of the case, the following are the major findings of the study:

1) *Rate regulation is a long, tedious and complicated process that traversed the realms of economics, law and politics.* It took ten long years to evolve from a ‘simple’ application for rate increase into a complicated legal drama whose financial, economic, political and other implications ran the whole gamut of public policy concerns. The latter include issues of commercial viability of firms, economic rights of consumers, private and public interests, the role of
the regulator and the courts, a reasonable and fair rate of return, and compensatory measures to disadvantaged sectors.

It involved four sets of industry regulators (three from the ERB and one for the new ERC), whose opinions and decisions differed and changed, based on their appreciation of the facts and realities surrounding ERB Case 93-118. It also included stakeholders other than the movant or petitioner, Meralco and the regulator, ERB, e.g., among others, other government bodies like the COA, the Office of the Solicitor General, the Court of Appeals, the Office of the President and the Supreme Court. Non-official but equally important policy stakeholders include private citizens, consumer groups, and industry organizations.

2) With regard to the question of **Who Benefited?**, the study learned that rate regulation is a pendulum of forces and legal maneuvers that swayed in favor of the utility firm at some points (1994 ERB decision and 1999 CA resolution) and tilted in favor of the consumers (COA Report of 1995, ERB Decision of 1998 and 2003 SC Decision) and the regulator at other points (2002 and 2003 Decisions of the Third Division of the SC).

The final resolution of the case appears to give due advantage though late and in only a small amount, to both the firm and its consumers. However, the refund options, e.g., either outright rebate or staggered or discounted rebates over a period of time, seem to favor Meralco more than the consumers who have already suffered (by paying higher bills than they should).

3) Specifically, with regard to the **Utility of Provisional Authority**, the study found out that the grant of PA is a two-bladed instrument of rate-regulation. On one hand it gives the petitioner firm the benefit of the doubt and allows it to provisionally increase and recover a reasonable and fair RORB. These are in order to make the firm more viable in providing public services. On the other hand and when contrary conditions apply and that a rebate or refund is ordered after a series of administrative processes, it becomes a debacle.

In this case, Meralco has used the proceeds of its rate increase to improve its power distribution system and diversify. If a bigger portion of money spent would be refunded to its customers, Meralco would not be in the best position to comply basically because the money is already spent. It was lulled to believing that the increase it sought was reasonably acceptable to the ERB.

On the other hand, if one would argue that the opportunity cost of the money already advantaged Meralco to the detriment of the consumers, then it is but fair to give back the money of the consumers. Meralco had already gained with the collections it spent while the hapless consumers continued to pay higher rates than authorized.
In addition, based on the principle of solutio in debiti as provided for in the Civil Code, Meralco has unduly enriched itself from the erroneous payment made by its customers. The legal principle stipulates that “an erroneous payment had been made and it was only fair that whoever received it should return it to the one(s) who made the ‘mistake’.” Since the latter paid an amount not really due or more than what was authorized Meralco, then it is only but fair that its customers should recover what they had ‘erroneously’ paid.

4) With regard to Consistency of Rule Application, the decisions in 1994, 1998 and 2003 appear as a rule change applied retroactively. However, the study argues that it is not because Meralco’s 1993 petition was provisionally granted in 1994 on the condition that

“Should the ERB find, after hearing and submission by COA of an audit report that Meralco is entitled to a lesser increase in rates, all excess amounts collected from the applicant’s customers shall either be refunded to them or correspondingly credited in their favor for application in electric bills covering future consumption.”

5) Meanwhile, the rate regulation process of Case 93-118 did not end in 1998 in ERB. Some sectors believe this is a failure on the part of ERB to impose its decisions on the regulated. However, because of the quasi-judicial nature of the processes and procedures adopted by ERB for rate regulation, ERB would insist it was only following rules. Thus, the ERB case 93-118 transcended Beyond the Quasi-Judicial Policy Arena towards the judicial arena and became Regulation by Lawsuits.

Appeals and other remedies and recourses for redress are available to litigating parties who perceive they were disadvantaged by the decision of the ERB and/or the courts. They provide the protagonists of the case the due process to be heard, to explain, to comment, to argue, to defend, and to rebut. They are indeed practically available to the petitioner firm, and even to the ERB. However, if the decision appears unfair to consumers, it seems that they practically have no recourse to further legal opposition because of resource and other constraints.

In the judicial and quasi-judicial process of balancing the vested interests of Meralco and the public, the case thence progressed into a legal battle of the brilliant arguments, wit and defense. It became a regulation by lawsuits, which at best, is cumbersome, time consuming, and costly.

6) Regulation is also a complex mix of continuous processes and procedures for rule adjudication, rule administration and policy and decision making. Specifically, by focusing on the rule making and adjudication roles of ERB, a quasi-judicial body in charge with economic utility regulation of the industry,
the study found that within the sphere delineated by law for a quasi-judicial/legislative body like the ERB, the latter acted primarily as an arbiter and a (legal) judge.

Matters normally litigated in court were settled by ERB in an atmosphere of technical expertise and comparative formality. ERB’s technical determinations were generally conclusive and binding upon the interests regulated, subject to adequate provision for review of legal questions by the courts. Due process consistent with protection of individual liberties was observed in regulatory proceedings. In addition, the citizens or firms were able to avail of special civil actions in challenging the regulator’s administrative actions.

With regard to the specific regulatory rules and procedures practiced in the ERB, the study surmised that these were very legalistic in the sense that they were patterned after those of the courts. Consequently, the workings of the industry regulator have required hearings on complaints or petitions, receiving evidence from opposing parties, deciding between the companies and the public as assumed litigants, and then issuing decisions or resolutions based on the technical records made in the course of the hearings. Thus, the regulatory process shifts to (quasi-)judicial proceedings in which the utilities and consumers constitute adverse litigating parties, and the industry regulator (e.g., ERB/ERC) acting as a court.

Under this quasi-judicial setting, public interest is subjected to litigation and treated more as a legal question instead of direct regulation. Substantive concerns, such as the morality of rate increases and the like are assessed using rule-based “factual” analysis rather than policy, management or governance approaches. Regulation that is supposed to balance public and private interests is not treated as an instrument of public policy, through adoption of clear objectives, appropriate standards and means for exact and systemic administration. Instead, it is treated as a question of facts and of law.

6) With regard to the representation of the public in the lawsuit, the study observed that the ‘public’ side has seldom outright and effective representation. Though in the case study, the ‘public’ was nevertheless well represented by the best legal minds (Office of the Solicitor General), and more importantly, by the seeming truer and more correct valuation of what is a reasonable and fair profit for Meralco as assessed by the 1998 ERB and COA. However, the participation of the OSG was more in defending the decision of the ERB. That of COA was more of an amicus curiae or a friend of the ‘court,’ which provided expertise in auditing and accounting and advised ERB on the economic and other implications of the decisions it would make. The ERB, on the other hand, acted more as a neutral arbiter because it was a quasi-judicial tribunal.
The representation of the public (consumers; public in general) appeared intermittent and fleeting, and only when the ‘public’ perceived they were adversely affected. There was involvement of a number of ‘consumer organizations and individuals’, e.g., electric cooperatives, big business, large federations of transport drivers and operators, local legislature (Sanggunian), big NGOs, Senators, et al. Ironically, the ordinary or small consumers were nowhere involved, and their interests not well-articulated. Many kept on the sidelines, either because they do not have the legal savvy to defend their positions, they have no funds, are ill informed, loosely organized, passive or apathetic.

In contrast, private side was very well represented as the petitioner firm had naturally assumed immediate responsibility to prepare and present its best side, without deflection of conflicting duties and restrictive circumstances. Meralco had almost, always, direct, adequate, and competent representation. It had all the resources at its disposal, e.g., capital, monopoly position in the distribution sector, access, full time utility economics division, legal researchers and the best of the legal minds in the likes of Yorac, Joker Arroyo, Torres, Makalintal, Sarmiento, and recently, Lorenzo Tanada Jr. The latter were street parliamentarians during the Marcos regime that fought for human rights, democracy and liberty. Now they are on the other side of the fence, defending a giant utility and its capitalist and commercial rights to fair returns and profit.

The case thus became a lopsided (legal) representation of interests in favor of the private interests.

7) In determining the reasonableness of the rate of return that may be granted the petitioner, the case metamorphosed into a question of fact and of law. As a question of fact, it was the regulator (ERB), which had the technical expertise and jurisdiction over the case. As a rule, its decisions should be final and treated with respect by the courts, as what the Third Division of the Supreme Court did.

As a question of law, e.g., whether ERB abused its discretion or not, or whether Meralco was afforded due process or not, it is the courts that intervened and should rule with finality. Abuse of discretion is the more important issue, which the SC en banc could deliberate on. Although as previously appreciated by the Third Division, such was a non-issue. Recall that the latter believed that the 1998 decision of the ERB was correct, fair, not unreasonable, and not confiscatory. In addition, Meralco was remiss in this burden when the Court ruled, “the burden to prove abuse of discretion is upon the oppositor, Meralco. In this case, it was unable to discharge this burden.”[169]
8. With regard to the *Composition of the Regulators and the Courts*, the study noted the following:
   a) The ERB of 1992 had only two years of familiarity with the industry (PEI) it was to regulate when it granted the provisional authority in 1994. It had little experience with the workings of the electric utilities as its expertise was in oil and gas. It gave Meralco the benefit of the doubt, despite or in spite of motions for the ERB Chair to inhibit himself in the deliberations of the case for alleged bias in favor of the firm.

   b) The ERB of 1998 and 2000 reviewed the case on hand and prodded the COA to submit its report of audit of the financial accounts of Meralco. It had more time to familiarize itself with the industry, with some members coming from industry participants and regulators like the NEA, COA and DOE. It did its own assessment of the case and armed with the zeal to see through the completion of the valuation, it studied relevant jurisprudence and rules on rate setting. It also relied on the COA findings and overturned the 1994 ERB decision.

   c) The ERC of 2001 has rules more geared towards the implementation of the EPIRA. Its rate determination task was more on the unbundling of rates and ensuring that it balances public and private interest through a more efficient and competitive industry. Its pro-competition stance may explain why it seems to favor, rightly or wrongly, the reevaluation of the 1998 ERB decision.

   Being a new and young regulator, the ERC is still in the process of learning the ropes of the game. In addition, it suffered a small set back when its first Chair resigned and went back to the Monetary Board. Another round of learning and relearning ensued, with its head in an interim capacity for almost a year. It was only recently that the President of the republic permanently appointed a replacement.

   d) The Court of Appeals, meanwhile, ruled on a question of law and substituted its own decision to the 1998 ERB’s. It set aside the ERB decision and stalled the order for Meralco to refund its consumers. The Supreme Court Third Division however in 2002, reversed the CA resolution and upheld the 1998 ERB decision. Its decision was appealed to the SC en banc.

   e) The SC is composed of men and women of integrity, competence and expertise. However, two of its members may be suspected of bias, as one was the Chair of the Twelfth Division of the CA, which reversed the 1998 ERB decision. Another was a main partner of the law firm, which counsels Meralco. For delicadeza, the two would inhibit themselves from the deliberations of the en banc. But we may never know what would indeed happen in the en banc deliberations as the working of the SC is like a black
Public hearings are however open and transparent.

Reversal of the SC of its own decisions is rare. Recently however, the SC has reversed itself in the issue of Kuratong Baleleng rubout. In the Meralco case, let us just hope that the SC make an enlightened, fair, objective and reasonable final decision for all concerned, based on the merits of the case, the rule of law and of men.

The High Court in the end did not disappoint us as it finally ended Meralco’s bid to stall the refund on April 30, 2003. It ordered the firm to refund its customers some P28B-excess charges from February 1994. It also ordered the ERC and other agencies concerned to work out the manner by which such refund could be made. However, the long road to determining who gets the refund, how long, and how much each consumer gets, has just been started.

In conclusion, the Philippine ‘model of regulation’ is similar to the US system in the sense that it is characterized by legal and procedural complexity, detailed statutes, formal rule making procedures, requirements for elaborate economic and scientific analyses and a great deal of legislative and judicial supervision. All these collectively put “heavy burdens on the regulatory process.”

Our model of regulation, using quasi-judicial/quasi-legislative industry regulators, has also undergone significant regulation by lawsuits. This is akin to Sappington’s (1986) characterization of regulation as a “significant process of judicialization”. The result is court-like proceedings before the regulatory commission and frequent recourse to the courts to review commission judgments.

By contrast, the Europe, especially UK model, intentionally emphasized pragmatism, where enabling legislation is written in schematic language, without complex standards or procedural requirements. Regulatory agencies take a case-to-case approach that demands a great deal of discretion. They prosecute firms far less often than their US counterparts. In the end, UK achieves about the same degree of control, but US industries bear heavier costs of compliance, and US agencies and pro-regulation groups spend more time and money doing their jobs.

The UK model also provides only a minor role for the judiciary. Legal recourse against a regulatory decision is limited to ‘judicial review,’ which is not concerned with the substance and merits of the decision, but merely with the process by which it is derived. However, based on the grounds of challenge for judicial review, ours to some extent is like the UK model. These grounds include abuse of discretion,
manifest error and irrationality in the decision making process, lack of due process and illegality.[174]

Whether our model of regulation will evolve into some eclectic model exhibiting features in other countries like UK and Australia or not is the question of the moment. The study could only surmise that based on its long tradition, it would take centuries before the Philippine model of regulation could drastically change from what it is now. With the legal mindset of most of our leaders and regulators, reforms in the regulators and our model of regulation would take a lot more time. Debates, deliberations, hearings and other legal and policy proceedings and activities would be required before consensus is arrived at and change effected.
Caution and restraint have been initially exercised in presenting this case study so as to uphold the principle of *sub judice* when discussing court decisions. In this principle, writers, researchers, reporters, et al. cannot comment in writing, orally or publicly on a pending case in such a way that the decision of the court could be influenced. There should be no problem if this writer keeps to the facts and evidence already presented during the trial, and refrains from speculation and opinion. However, since the case is already decided enfin, no threats of charges in contempt of court are evident, and in the spirit of academic freedom, the author proceeded with the case study and offered her two cents-worth of opinions on the matter.

Recall the severe power crisis in the late 1980s to early 1990s, which paralyzed industries and the economy in general. Power outages lasting for twenty-four hours had been happening because of the breakdown of old and aging inefficient power plants of the NPC. Other sectors also believe that the power crisis was a consequence of the abolition of the DOE and the mothballing of the NPC nuclear power plant in Morong, Bataan by the Aquino government. Thereafter, the succeeding administrations (Ramos and Estrada) adopted executive and legislative remedies to resolve the power crisis, among them, the Electric Power Crisis Act and the Build-Operate-Transfer (BOT) Laws. In fairness, the Aquino administration opened up the PEI and started the reforms to restructure the electricity sector (by abolishing the power generation monopoly of NPC) with EO 215 and the first BOT Law. See discussions on Chapter 3 of the author’s dissertation.

Meralco’s computation of the rate base in 1993 was adjusted to P27.564B from P25.590B to reflect the appraisal increase on the utility plant at price levels on September 23, 1993. This was based on the peso-dollar conversion of P29.805/US$1.00 (ERB Case 93-118 Application Petition, p. 3).

The P=$ conversion rate at that time (1993) was about P29.80 = US$1, according to Meralco economists.

Recall that Section 16 (c) of the PSA states “the power of the PSC/ERB, upon proper notice and hearing in accordance with this Act...To fix and determine individual or joint rates, toll charges, classifications, or schedules thereof...and other special rates, which shall be imposed, observed, and followed thereafter by any public service. Provided, that the Commission (Board) may, in its discretion, approve rates proposed by public services provisionally and without necessity of any hearing; but it shall call thereon within thirty days thereafter, upon publication and notice to the concerns operating in the territory affected...”

Section 8 of EO 172 or the ERB Act of 1987, meanwhile stipulates the authority of the ERB to grant provisional relief, to wit:

“The Board, upon filing of an application, petition or complaint, or at any stage thereafter and without prior hearing, on the basis of supporting papers duly verified or authenticated, grant provisional relief on motion of a party in the case or on its own initiative, without prejudice to a final decision after hearing, should the Board find the pleadings...substantially support the provisional order. The Board shall, however, immediately schedule and conduct a hearing thereon within thirty (30) days thereafter, upon publication and notice to all affected parties.”

Chairman Tantionage is an accountant who moved to two other government agencies, e.g., Philippine Airlines (PAL) and the Metropolitan Waterworks and Sewerage System (MWSS) Regulatory Office, after his stint with ERB. He and Atty. Ala are now with Orion, a consultancy firm. Atty. Faylona is now deceased. Another lawyer, Atty. Castaneda used to work with Manila Gas as (legal) counsel. Engr. Baldonado worked with Manila Gas, also.

Balut is in Tondo, Manila, one of the depressed areas in Metro-Manila.

These counsels represent the brightest and most brilliant breeds of lawyers in the country. Many have been street parliamentarians during the Marcos dictatorship and transited to become cabinet...
members of the post-Marcos administrations. Haydee Yorac was a Member of the Commission of Elections (Aquino years, 1986-1991) and now, Chair of the Presidential Commission on Good Government (Arroyo period). Adolf Azcuna was the Press Secretary (Aquino years). He is now a member of the Supreme Court where Meralco has filed a motion for reconsideration of SC’s Third Division decision on refund. Joker Arroyo was the Executive Secretary (Aquino period) and currently a Senator of the Republic. They were highly connected to the corridors of power when this Meralco application was filed.

[k] In addition and as earlier reiterated, this power to grant provisional authority without prior hearing is stipulated in EO 172 or the ERB Act of 1987 and CA 146 or the Public Service Act of 1936.

[l] According to the 1994 Meralco Annual Report (p. 4), this period saw “the company’s net income increasing by 122% from the P1.6 billion level as of year-end 1993, to an unprecedented level of P3.6 B in 1994. This was due to the adequacy of the power supply throughout the year and the effect of the provisional rate increase granted Meralco on January 28, 1994.”

[m] The Memorandum was prepared by Haydee B. Yorac of the Azcuna Yorac Sarmiento Arroyo and Chua Law Office, and Manuel L.M. Torres of the Quiason Makalintal Barrot Torres and Ibarra (Law Firm). As earlier mentioned, these belong to the best and most brilliant lawyers “around town”. In addition to their legal acumen, they are also politically connected.

[n] The AACI is an independent audit firm that did the appraisal of Meralco assets in 1993.

[o] Dr. Pedro Gil was the Chairman of the Public Service Commission at that time, e.g., 1957.

[p] Honorable Board Member Ocampo became the ERB Chairperson in 2000.

[q] By this time, the ERB had been on its sixth year learning the practice of rate regulation, taking over this function from the National Power Board in 1992. Recall that the 1994 ERB Board that granted provisional authority for Meralco to increase its rates was relatively “new” to this profession as its previous expertise was on the regulation of the Philippine oil industry. See discussions on Chapters 3 and 4.

[r] The reproduction cost in the RCND refers to the cost of constructing the same facility at recent or present prices and then subtracting any perceived depreciation. While the RCND takes into account the changing cost of money, it is highly subjective and inexact. This method provides a high asset valuation favorable to the investor. It gives a built-in advantage to the petitioner (in this case, Meralco), at the expense of the consumers (ERB Motion for reconsideration with the Court of Appeals, March 18, 1999, p.20).

[s] See earlier section on the ERB Appeal with the CA.

[t] Recall that in the ERB Petition with the CA, it distinguished direct and indirect taxes. Direct tax is demanded from the person who shoulders the burden of the tax. An indirect tax is levied upon transactions or activities before the articles subject matter thereof reach the customers to whom the burden of the tax may be ultimately charged or shifted (Vitug and De Leon, as cited in the ERB Petition with the Supreme Court, February 23, 2000, pp. 10-11).

[u] As earlier explained, the rule “stare decisis” rests on the desirability of having stability in the law...

[v] Recall that among the Meralco assets amounting to P2.5B, which were disallowed by COA in 1995 were various parcels of land, construction work-in-progress, Rockwell Thermal Power Plant (which is now a shopping mall), Meralco Theater, Meralco Shooting Range, Mesala/PCIB, John F. Cotton Hospital, Jollye Recreation Center, Computer Information System (CIS), and Long Ranger Helicopter.

[w] As opposed to being a question of law, of which the courts have jurisdiction over.

[x] The ERB is technically not a ‘court’. It is but a quasi-judicial tribunal.


[33] SAO 95-07 Report, February 11, 1997
[34] SAO 95-07 Report, February 11, 1997
[38] Memorandum of Meralco to ERB, in support of its exceptions/objections to the SAO 97-07 Report, January 5, 1998, pp. 3-6.
[47] Mr. Tagaza, Vice President and Controller of Meralco, as cited in Meralco Memorandum of 1998.
[63] ERB Decision of 1998, p. 44.
[77] Supreme Court Ruling, 18 SCRA 651, at 655 as cited in Meralco Petition with the Court of Appeals, CA GR No. 46888, February 23, 1998, pp. 9-10.
[79] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.

[84] Schwartz, Administrative Law, 303; Cooper, The Lawyers and Administrative Agencies, 252; Davis, Administrative Law, 352-354, as cited in Meralco Petition with the Court of Appeals, CA GR No. 46888, February 23, 1998, p. 25.
[85] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.
[86] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.
[87] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.
[88] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.
[89] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.
[90] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.
[91] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.
[92] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.
[93] ERB Decision on Case 91-70 as cited in Court of Appeals Decision of February 24, 1999, pp. 11-12.
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ERB Motion for Reconsideration with the Court of Appeals, March 18, 1999, p. 12.

ERB Motion for Reconsideration with the Court of Appeals, March 18, 1999, p. 12.

ERB Motion for Reconsideration with the Court of Appeals, March 18, 1999, p. 6.

ERB Motion for Reconsideration with the Court of Appeals, March 18, 1999, p. 6.

ERB Motion for Reconsideration with the Court of Appeals, March 18, 1999, p. 9.

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