EN BANC

[G.R. No. 226443, October 08, 2019]

NATIONAL ASSOCIATION OF ELECTRICITY CONSUMERS FOR REFORMS, INC., PETITIONER, VS. ENERGY REGULATORY COMMISSION, MANILA ELECTRIC COMPANY, AND COMMISSION ON AUDIT, RESPONDENTS.

CLARK ELECTRIC DISTRIBUTION CORPORATION, DAGUPAN ELECTRIC CORPORATION, ANGELES ELECTRIC CORPORATION, CAGAYAN ELECTRIC POWER & LIGHT COMPANY, INC., SAN FERNANDO ELECTRIC LIGHT & POWER COMPANY, INC., CABANATUAN ELECTRIC CORPORATION, TARLAC ELECTRIC, INC., AND OLONGAPO ELECTRICITY DISTRIBUTION COMPANY, INC., MOVANT-INTERVENORS

D E C I S I O N

CARPIO, J.:

The Case

The present petition for review on certiorari[1] filed by petitioner National Association of Electricity Consumers for Reforms, Inc. (NASECORE) assails the Decision[2] dated 29 February 2016 and the Resolution[3] dated 18 August 2016 of the Court of Appeals (CA) in CA-G.R. SP No. 129052. The CA affirmed the Orders[4] dated 21 June 2011 and 4 February 2013 of the Energy Regulatory Commission (ERC) in ERC Case Nos. 2001-646 and 2001-900.

The Facts

The facts, as culled from the records, are as follows:

In *MERALCO v. Genaro Lualhati (Lualhati)*,[5] the Court directed the ERC to request the Commission on Audit (COA) to undertake a complete audit on the books, records, and accounts of Manila Electric Company, Inc. (MERALCO) relative to its provisionally-approved rate increases and unbundled rates. The dispositive portion of this Court's Decision dated 6 December 2006 states:

> WHEREFORE, the petition is *GRANTED*. The 22 July 2004 Decision and 24 January 2005 Resolution of the Court of Appeals in CA G.R. SP No. 77559 are hereby *SET ASIDE*. The ERC Decision dated 20 March 2003 and its Order dated 30 May 2003 in ERC Case Nos. 2001-646 and 2001-900 are REINSTATED subject to the above disquisitions.
>
> The Energy Regulatory Commission is, thus, directed to request the COA to undertake a complete audit the books, records and accounts of MERALCO relative to its provisionally-approved rate increases and unbundled rates.
>
> SO ORDERED.[6]

In its Order dated 12 January 2007, the ERC requested COA to conduct an audit of MERALCO's books, accounts and records to determine: (a) whether the implementation of the approved distribution rates resulted in a fair return; and (b) whether the recovery of generation costs had been revenue-neutral to MERALCO. The COA conducted the audit pursuant to MS/TS Office Order No. 2008-015 dated 8 September 2008.

On 12 November 2009, the COA transmitted to the ERC its Special Audits Office Report No. 2009-01 Rate Audit of Unbundled Charges of MERALCO (COA Report).[7]

The COA Report states that: (1) the audit covered the test years 2004 and 2007, as the unbundled rates were implemented in June 2003; (2) the team performed the following: a) accounted for revenues generated from approved rates and those earned from related activities; b) reviewed property and equipment accounts to ascertain propriety and values to be considered in rate base; c) conducted ocular inspection of selected transmission substations and branches to determine existence, condition and

usage; d) reviewed operating expense accounts to determine expenses recoverable from consumers; and e) accounted for generation costs and related revenues;[8] and (3) the rate-setting methodology used is a cost based method known as Return on Rate Base (RORB).[9]

The audit disclosed the impact on MERALCO's revenue structure upon implementation of the approved distribution rates computed at three different rates of return: (1) the ERC-approved rate of return of 15.50% based on MERALCO's Weighted Average Cost of Capital (WACC) for 2000; (2) the actual WACC of 12.80% and 11.70% for CYs 2004 and 2007, respectively; and (3) the reasonable rate of return of 12% established in jurisprudence using both historical costs and appraised values, tabulated as follows:

	Excess (Deficiency) Revenue Computed Based on			
Rate of Return	2004		2007	
	Historical Cost	Appraised Value	Historical Cost	Appraised Value
Approved Rate of 15.50% based on WACC	P6,756,940,879	P2,590,667,993	P2,207,598,653	P(1,272,322,123)
Actual WACC: CY 2004 (12.80%) CY 2007 (11.70%)				
	8,142,009,602	4,701,474,573		
			4,561,646,651	1,934,867,743
Reasonable rate of return of 12% established in jurisprudence	P8,552,400,334	P5,326,898,745	P4,375,800,757	P1,681,668,543

The COA Report further states that the excess or deficiency in distribution revenues was determined after considering the following factors in establishing MERALCO's revenue requirements: a) certain operating expenses, which include employee pension and other benefits, amounting to P3.479 billion and P2.916 billion for 4004 and 2007, respectively, were not considered recoverable from the consumers as these were not reasonable and necessary in the delivery of distribution services; and b) certain property and equipment amounting to P3.701 billion and P3.586 billion for 2004 and 2007, respectively, were not considered by the team as part of the rate base as these were not used and useful in the distribution operation during the test period.[10]

In an Order dated 15 February 2010, the ERC directed the intervenors to comment on the COA Report. On 2 March 2010, Genaro Lualhati filed his Comment, while NASECORE filed its Comment on 5 April 2010.

In its Comment, NASECORE alleged that: (1) the rate of return granted to MERALCO in 2003 was 15.50%, which was 3.5% higher than the 12% established and adopted by administrative and judicial bodies; (2) based on its excessive revenue, MERALCO should not be entitled to rate increase in 2003 and the ERC should direct it to refund its excess profits; (3) the ERC should hold in abeyance any further rate increase of MERALCO until after conducting a complete audit of its books, accounts and records for the years 1987 to the present; and (4) the COA report confirmed that MERALCO's provisionally approved unbundled rates were oppressive and exorbitant.

In its Comment, MERALCO alleged that: (1) the ERC has the final decision on matters involving rates; (2) the pension and benefits are reasonable costs of a utility and are recoverable expenses; (3) certain assets disallowed by COA have been consistently upheld by the ERC as used and useful in providing utility service; and (4) the basis whether it exceeded its return should be 15.5% and the ERC is not bound to maintain its rate of return at 12%.

The Ruling of the ERC

In its Order[11] dated 21 June 2011, the ERC affirmed its findings and conclusions in its Decision dated 20 March 2003 and Order dated 20 May 2003, and declared MERALCO's approved unbundled rates final. The ERC held that COA's findings of "excess revenues" or "over-recovery" on the part of the MERALCO were due to the following factors: 1) the application of the disallowances under MERALCO's Performance Based Rate (PBR) application to its RORB application; 2) the calculation of MERALCO's revenues using historical costs of the assets and a 12% RORB; and 3) the calculation of MERALCO's disallowances and revenues without regard to incrementals.

The ERC found that COA's application of the disallowances under MERALCO's PBR application to its RORB application is not supported by established rules on rate-making, and that it is a clear violation of the principle against retroactive rate-making, which prohibits the adjustment of rates previously fixed by the regulatory body following a prescribed procedure. The ERC also found that COA's calculation of MERALCO's revenues using the historical costs of the assets and a 12% rate of return is contrary to existing laws and jurisprudence, which allows the use of present market value in fixing the rates to be applied prospectively and the use of a WACC in determining the reasonable return to which the utility is entitled. The ERC likewise found that COA's calculation cannot be adopted because it failed to take into account the incrementals, and the revenues for 2000 should not be compared to revenues for 2004 and 2007 to determine whether they were reasonable.

In its Order[12] dated 4 February 2013, the ERC denied the motion for reconsideration filed by NASECORE for lack of merit. Thus, NASECORE filed an appeal.

The Ruling of the Court of Appeals

In its Decision[13] dated 29 February 2016, the CA found that the ERC dutifully complied with this Court's Order in *Lualhati*. The CA explained that the conduct of a COA audit is not a requisite for the ERC's exercise of its rate-fixing powers, and the ERC is not bound to accept and adopt any finding that the COA audit may come up with. Furthermore, the CA held that it would be highly unlikely that the COA will come up with a conclusion similar to that of ERC given COA's use of different factors, *i.e.* test year and accounting methodology. The CA found that there was no reason for the COA to use an accounting methodology other than that used by MERALCO when it applied for the rate increase. Thus, the CA concluded that the ERC acted correctly when it did not adopt the COA Report in its entirety, because it cannot determine whether the rate increase granted to MERALCO was justified.

> Thus, the dispositive portion of the CA Decision states:
>
> WHEREFORE, premises considered, the petition is DISMISSED. The Orders dated June 21, 2011 and February 4, 2013, respectively, of the Energy Regulatory Commission in ERC Case Nos. 2001-646 and 2001-900 are AFFIRMED.
>
> SO ORDERED.[14]

In a Resolution[15] dated 18 August 2016, the CA denied the motion for reconsideration filed by NASECORE on 22 March 2016. On 3 October 2016, NASECORE filed the present petition before us. Subsequently, MERALCO, COA and the ERC, through the Office of the Solicitor General (OSG), filed their Comment.

On 22 June 2017, movant-intervenors Clark Electric Distribution Corporation, Dagupan Electric Corporation, Angeles Electric Corporation, Cagayan Electric Power & Light Company, Inc., San Fernando Electric Light & Power Company, Inc., Cabanatuan Electric Corporation, Tarlac Electric, Inc., and Olongapo Electricity Distribution Company, Inc., (collectively, intervenors) filed a Motion for Leave to Intervene and Admit Attached Comment-In-Intervention (Motion),[16] essentially alleging that (1) the instant case involves a matter of transcendental importance, (2) they have a legal standing to intervene as electric distribution utilities, and they will be directly and substantially affected if a ruling is held that a COA audit is a prerequisite in granting rate applications.

In a Resolution[17] dated 11 July 2017, the Court resolved to require the adverse parties to Comment on the Motion. Thereafter, NASECORE, ERC, through the OSG, MERALCO and the COA filed their respective Comments to the Motion.

The Issues

In the present petition, NASECORE raises the following issues for resolution:

> I. WHETHER OR NOT RESPONDENT ENERGY REGULATORY COMMISSION (ERC) GAVE PROPER WEIGHT AND CREDENCE TO THE FINDINGS OF THE COMMISSION ON AUDIT;
>
> II. WHETHER OR NOT MERALCO'S OPERATING EXPENSES (OPEX) SUCH AS EMPLOYEES' PENSION AND OTHER BENEFITS AMOUNTING TO PHP3.148 BILLION IN 2004 AND PHP3.228 BILLION IN 2007 ARE RECOVERABLE FROM THE CONSUMERS;

III. WHETHER OR NOT CERTAIN PROPERTIES AND FACILITIES AMOUNTING TO PHP3.848 BILLION IN 2004AND PHP3.069 BILLION IN 2007 SHOULD BE CONSIDERED AS PART OF THE RATE BASE - E.G. THE MERALCO THEATER, MERALCO MUSEUM, MERALCO WELLNESS CENTER, MERALCO SHOOTING RANGE, MERALCO TENNIS COURT/FITNESS CENTER/OVAL/OPEN SPACE[;]

IV. WHETHER OR NOT ALL COSTS RECOVERED BY MERALCO FROM THE CONSUMERS IN EXCESS OF LIMITS ALLOWED BY LAW SHOULD BE TREATED AS "OVER RECOVERY" AND REFUNDED TO THE CONSUMERS ACCORDINGLY.[18]

The Ruling of the Court

We partly grant the petition.

Section 38 of the Government Auditing Code of the Philippines and Book V, Title I, Subtitle B, Chapter 4, Section 22[19] of the Administrative Code of 1987 specifically authorize the COA to examine accounts of public utilities in connection with the fixing of rates of every nature. Section 38 of the Government Auditing Code of the Philippines provides:

> Section 38. *Authority to examine accounts of public utilities:*
>
> 1. ***The Commission shall examine and audit the books, records, and accounts of public utilities in connection with the fixing of rates of every nature***, or in relation to the proceedings of the proper regulatory agencies, for purposes of determining franchise taxes.
>
> 2. During the examination and audit, the public utility concerned shall produce all the reports, records, books of accounts and such other papers as may be required. The Commission shall have the power to examine under oath any official or employee of the said public utility.
>
> 3. Any public utility refusing to allow an examination and audit of its books of accounts and pertinent records, or offering unnecessary obstruction to the examination and audit, or found guilty of concealing any material information concerning its financial status shall be subject to the penalties provided by law. (Boldfacing and italicization supplied)

Thus, in *MERALCO v. Lualhati*[20] (*Lualhati*), we directed the ERC to seek the assistance of the COA in conducting a complete audit on the books, records and accounts of MERALCO to see to it that the rate increases that MERALCO has asked for are reasonable and justified, to wit:

> Contrary to the Court of Appeals' insinuation that the ERC did not perform its legal mandate to protect the public, the foregoing disquisitions of the ERC speak otherwise. MERALCO's proposed revenue requirement and rate base for purposes of fixing its rates were, after having been assumed to be carefully considered, adjusted downwards. MERALCO did not get what it prayed for, which was a rate higher than that approved by the ERC.
>
> The established rule in this jurisdiction is that findings of administrative or regulatory agencies on matters within their technical area of expertise are generally accorded not only respect but finality if such findings are supported by substantial evidence. Rate-fixing calls for a technical examination and a specialized review of specific details which the courts are ill-equipped to enter; hence, such matters are primarily entrusted to the administrative or regulating authority. Thus, this Court finds no reversible error on the part of ERC in rendering its assailed decision and order.

However, while ruling in said manner, this Court is cognizant that such ruling has far-reaching effects dud is of utmost significance to the public, especially to the poor, who face the threat of deeper wallowing in the quagmire of financial distress once the burden of electricity rate increases is passed on to them. Better judgment, therefore, calls for this Court to temper the rigidity of its decision.

Although affirming the decision and the order of the ERC approving the rate increases for electricity, this Court is not closing its eyes to the fundamental principle of social justice so emphatically expressed by the late President Magsaysay in his statement: "He who has less in life should have more in law."

The concern for the poor is recognized as a public duty, and the protection of the rights of those marginalized members of society have always dutifully been pursued by the Court as a sacred mission. Consistent with this duty and mission, the Court deems it proper to approve the rate increases applied for by MERALCO provisionally, *i.e.*, MERALCO to impose provisional rate increases while directing **the**

ERC, at the same time, to seek the assistance of COA in conducting a complete audit on the books, records and accounts of MERALCO to see to it that the rate increases that MERALCO has asked for are reasonable and justified. Stated otherwise, the provisional rate increases will continue to be subject to its being reasonable and just until after the ERC has taken the appropriate action on the COA Report.[21] (Emphasis supplied)

Consistent with its mandate and our ruling in *Lualhati* that a prior COA audit is not mandatory in rate-fixing, the COA conducted a **post-audit** on the books, records and accounts of MERALCO to see if the rates asked for are reasonable and just, and "**recommend[ed**] that the results of the audit be considered by the ERC in deciding the MERALCO cases."[22]

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 a valid exercise thereof.[23] In regulating rates charged by public utilities, the State protects the public against arbitrary and excessive rates while maintaining the efficiency and quality of services rendered.[24] The fixing of just and reasonable rates involves a balancing of the investor and the consumer interests.[25] While the power to fix rates is a legislative function, whether exercised by the legislature itself or delegated through an administrative agency, such as the ERC, a determination of whether the rates so fixed are reasonable and just is a purely judicial question and is subject to the review of the courts.[26]

Thus, in determining the just and reasonable rates to be charged by a public utility, three major factors are considered by the regulating agency: a) *rate of return*, that is a judgment percentage which, if multiplied with the rate base, provides a fair return on the public utility for the use of its property for service to the public; b) *rate base*, that is an evaluation of the property devoted by the utility to the public service or the value of invested capital or property which the utility is entitled to a return; and c) the *return* itself or the computed revenue to be earned by the public utility based on the rate of return and rate base.[27] In the most simple terms, the traditional rate formula, designed to produce the utility's revenue requirement, is **R** = **O** + (**V-D**) **r**, where: **R** is the public utility's total revenue requirement; **O** is the public utility's operating expenses; **V** is the gross value of the public utility's tangible and intangible property; **D** is the utility's accrued depreciation; combined (**V-D**) constitute the utility's *rate base*, also known as its capital investment; and **r** is the *rate of return* a utility is allowed to earn on its capital investment.[28]

At issue here is whether the ERC erred in not adopting the recommendation of the COA, particularly as to: (1) the determination of the kind and the amount of operating expenses that should be allowed to MERALCO and (2) the proper valuation of the rate base or the value of the property entitled to a return.

In its Order[29] dated 21 June 2011 the ERC stated that:

> *Operating Expenditures (OPEX)*
>
> MERALCO's OPEX, per its books for CYs 2004 and 2007, were at Php14,851,187,785.00 and Php17,744,879,185.00, respectively. **The COA made some disallowances on the OPEX based on the principles laid down under the PBR Methodology. Since the approved OPEX was determined under the RORB Methodology for the test year 2000, there was no mechanism to account for any incremental cost.**
>
> **In the unbundling of MERALCO's rates, the items "pensions and other benefits" amounting to Php1.381 Billion was allowed to be recovered based on test year 2000. The COA disallowed pensions and other benefits which increased to Php3.148 Billion in 2004 and Php3.228 Billion in 2007. These amounts are already considered as incremental costs.**
>
> *Asset Base*
>
> The Commission approved MERALCO's rate base after review and evaluation of its books as of year-end 1998, asset appraisal performed on September 19, 1999 and at cost for year ending December 31, 2000.
>
> **The COA determined MERALCO's assets in service based on historical and appraised book values for the years 2004 and 2007. The Commission believes that the audit conducted disregarded the fact that for purposes of determining the utility's rate base, the present or market value of its properties should be determined.** The assessment of the assets changes over time such that some of these assets may have