Supreme Court E-Library

THIRD DIVISION

[G.R. No. 141314. November 15, 2002]

REPUBLIC OF THE PHILIPPINES, REPRESENTED BY ENERGY REGULATORY BOARD, *petitioner, vs.* **MANILA ELECTRIC COMPANY,** *respondent.*

[G.R. No. 141369. November 15, 2002]

LAWYERS AGAINST MONOPOLY AND POVERTY (LAMP) consisting of CEFERINO PADUA, Chairman, G. FULTON ACOSTA, GALILEO BRION, ANATALIA BUENAVENTURA, PEDRO CASTILLO, NAPOLEON CORONADO, ROMEO ECHAUZ, FERNANDO GAITE, ALFREDO DE GUZMAN, ROGELIO KARAGDAG, JR., MA. LUZ ARZAGA-MENDOZA, ANSBERTO PAREDES, AQUILINO PIMENTEL III, MARIO REYES, EMMANUEL SANTOS, RUDEGELIO TACORDA, members, and ROLANDO ARZAGA, Secretary-General, JUSTICE ABRAHAM SARMIENTO, SENATOR AQUILINO PIMENTEL, JR. and COMMISSIONER BARTOLOME FERNANDEZ, JR., Board of Consultants, and Lawyer GENARO LUALHATI, *petitioners, vs.* **MANILA ELECTRIC COMPANY (MERALCO),** *respondent.*

SYNOPSIS

The Court here resolves the following issues: 1. Whether the income tax paid by Meralco should be treated as part of its operating expenses and thus considered in determining the amount of increase in the electric rates. 2. Whether it is the net average investment method of the COA and the ERB, or the average investment method of the Meralco that should be used.

On the first issue, the Court ruled in the negative. Income tax paid by a public utility is inconsistent with the nature of

Supreme Court E-Library

operating expenses. Operating expenses are those which are reasonably incurred in connection with business operations to yield revenue or income. Income tax is imposed on the entity, for the privilege of earning income and for the benefits received by the taxpayer from the State. On the second issue, the Court ruled on the propriety of using the net average investment method in the determination of the rate base. The ERB did not abuse its discretion when it applied the method as its reasonableness is borne by the records of the case. Meralco had not adequately shown that the rates prescribed by the ERB are unjust or confiscatory as to deprive its stockholders a reasonable return on investment.

SYLLABUS

1. POLITICAL LAW; INHERENT POWERS OF THE STATE; POLICE POWER; REGULATION OF RATES TO BE CHARGED BY PUBLIC UTILITIES FOUNDED THEREON.— 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. 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. Submission to regulation may be withdrawn by the owner by discontinuing use; but as long as use of the property is continued, the same is subject to public regulation. 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. However, the power to regulate rates does not give the State the right to prescribe rates which are so low 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 the services rendered.* The fixing of just and reasonable rates involves a *balancing* of the investor and the consumer interests.

2. REMEDIAL LAW; EVIDENCE; FINDINGS OF THE ENERGY REGULATORY BOARD ON THE DETERMINATION OF PROPER ENERGY RATES; RESPECTED.— While the power

Supreme Court E-Library

to fix rates is a legislative function, whether exercised by the legislature itself or delegated through an administrative agency, 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. 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. In one case, we cautioned that courts should "refrain from substituting their discretion on the weight of the evidence for the discretion of the Public Service Commission on questions of fact and will only reverse or modify such orders of the Public Service Commission when it really appears that the evidence is insufficient to support their conclusions." In the cases at bar, 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. 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 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.

3. **POLITICAL LAW; ADMINISTRATIVE LAW; ENERGY REGULATORY BOARD; ON FIXING RATES TO BE CHARGED IN THE DISTRIBUTION OF ELECTRICITY; DETERMINES WHAT IS REASONABLE AND JUST.**— The ERB was created under Executive Order No. 172 to regulate, among others, the distribution of energy resources and to fix rates to be charged by public utilities involved in the distribution of electricity. In the fixing of rates, *the only standard* which the legislature is required to prescribe for the guidance of the administrative authority is that the *rate be reasonable and just.* It has been held that even in the absence of an express requirement as to reasonableness, this standard may be implied. *What is a just and reasonable rate is a question of fact calling for the exercise of discretion, good sense, and a fair, enlightened and independent judgment.* The requirement of reasonableness

Supreme Court E-Library

comprehends such rates which must not be so 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 of the utility. *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; b) rate base; 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.* The rate of return 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. The rate of return of a public utility is not prescribed by statute but by administrative and judicial pronouncements. This Court has consistently adopted a 12% rate of return for public utilities. The rate base, on the other hand, 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.

4. ID.; ID.; ID.; ID.; INCOME TAX NOT INCLUDED IN THE COMPUTATION OF OPERATING EXPENSES OF A PUBLIC UTILITY.— In determining whether or not a rate yields a fair return to the utility, the operating expenses of the utility must be considered. The return allowed to a public utility in accordance with the prescribed rate must be sufficient to provide for the payment of such reasonable operating expenses incurred by the public utility in the provision of its services to the public. Thus, the public utility is allowed a return on capital over and above operating expenses. However, only such expenses and in such amounts as are reasonable for the efficient operation of the utility should be allowed for determination of the rates to be charged by a public utility. 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 or are attributable 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

Supreme Court E-Library

utility, recurring, and that it redounds to the service or benefit of customers." Income tax, it should be stressed, is imposed on an individual or entity as a form of excise tax or a tax on the privilege of earning income. In exchange for the protection extended by the State to the taxpayer, the government collects taxes as a source of revenue to finance its activities. Clearly, by its nature, income tax payments of a public utility are not expenses which contribute to or are incurred in connection with the production of profit of a public utility. Income tax should be borne by the taxpayer alone as they are payments made in exchange for benefits received by the taxpayer from the State. No benefit is derived by the customers of a public utility for the taxes paid by such entity and no direct contribution is made by the payment of income tax to the operation of a public utility for purposes of generating revenue or profit. *Accordingly, the burden of paying income tax should be Meralco's alone and should not be shifted to the consumers by including the same in the computation of its operating expenses.*

5. ID.; ID.; ID.; DETERMINATION OF THE RATE BASE ON THE PROPERTY USED IN THE OPERATION OF THE PUBLIC UTILITY; NET AVERAGE INVESTMENT METHOD AND AVERAGE INVESTMENT METHOD.— In the determination of the rate base, property used in the operation of the public utility must be subject to appraisal and evaluation to determine the fair value thereof entitled to a fair return. With respect to those properties which have not been used by the public utility for the entire duration of the test year, *i.e.*, the year subject to audit examination for rate-making purposes, a valuation method must be adopted to determine the proportionate value of the property. Under the "*net average investment method*," properties and equipment used in the operation of a public utility are entitled to a return only on the actual number of months they are in service during the period. In contrast, the "average investment method" computes the proportionate value of the property by adding the value of the property at the beginning and at the end of the test year with the resulting sum divided by two.

6. ID.; ID.; ID.; ID.; ID.; PROPRIETY OF THE NET AVERAGE INVESTMENT METHOD.— The ERB did not abuse its discretion when it applied the net average investment method. The reasonableness of net average investment method is borne

Supreme Court E-Library

by the records of the case. In its report, the COA explained that the computation of the proportionate value of the property and equipment in accordance with the *actual number of months* such property or equipment is in service for purposes of determining the rate base is favored, as against the trending method employed by MERALCO, "to reflect the real status of the property." By using the net average investment method, the ERB and the COA considered for determination of the rate base the value of properties and equipment used by MERALCO in proportion to the period that the same were *actually used* during the period in question. This treatment is consistent with the settled rule in rate regulation that the determination of the rate base of 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.

APPEARANCES OF COUNSEL

The Solicitor General for petitioner in G.R. No. 141314.
Ceferino Padua Law Office for LAMP.
Quiason Makalintal Barot Torres & Ibarra for MERALCO.

D E C I S I O N

PUNO, *J.*:

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. The cases at bar are of utmost significance for they concern the right of our 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 respondent MERALCO, a giant public utility and a monopoly, to charge our people for their electric consumption. The question is: should public interest prevail over private profits?

The facts are brief and undisputed. On December 23, 1993, MERALCO filed with the ERB an application for the revision

Supreme Court E-Library

of its rate schedules. *The application reflected an average increase of 21 centavos per kilowatt hour (kwh) in its distribution charge.* The application also included a prayer for provisional approval of the increase pursuant to Section 16(c) of the Public Service Act and Section 8 of Executive Order No. 172.

On January 28, 1994, *the ERB issued an Order granting a provisional increase of ₱0.184 per kwh,* subject to the following condition:

"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 the applicant that the latter is entitled to a 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 consumptions."[1]

In the same Order, the ERB requested the Commission on Audit (COA) to conduct an "audit and examination of the books and other records of account of the applicant for such period of time, which in no case shall be less than 12 consecutive months, as it may deem appropriate" and to submit a copy thereof to the ERB immediately upon completion.[2]

On February 11, 1997, the COA submitted its Audit Report SAO No. 95-07 (the "COA Report") which contained, among others, the recommendation not to include income taxes paid by MERALCO as part of its operating expenses for purposes of rate determination and the use of the net average investment method for the computation of the proportionate value of the properties used by MERALCO during the test year for the determination of the rate base.[3]

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[1] *Rollo*, G.R. No. 141314, p. 116.

[2] *Id.*

[3] *Id.* at 164-66 and 168.

Supreme Court E-Library

Subsequently, the ERB rendered its decision adopting the above recommendations and authorized MERALCO to implement a rate adjustment in the average amount of ₱0.017 per kwh, effective with respect to MERALCO's billing cycles beginning February 1994. The ERB further ordered that "the provisional relief in the amount of ₱0.184 per kilowatt hour granted under the Board's Order dated January 28, 1994 is hereby superseded and modified and the excess average amount of ₱0.167 per kilowatt hour starting with MERALCO's billing cycles beginning February 1994 until its billing cycles beginning February 1998, be refunded to MERALCO's customers or correspondingly credited in their favor for future consumption."[4]

The ERB held that income tax should not be treated as operating expense as this should be "borne by the stockholders who are recipients of the income or profits realized from the operation of their business" hence, should not be passed on to the consumers.[5] Further, in applying the net average investment method, the ERB adopted the recommendation of COA that in computing the rate base, only the proportionate value of the property should be included, determined in accordance with the number of months the same was actually used in service during the test year.[6]

On appeal, *the Court of Appeals set aside the ERB decision insofar as it directed the reduction of the MERALCO rates by an average of ₱0.167 per kwh and the refund of such amount to MERALCO's customers beginning February 1994 and until its billing cycle beginning February 1998.*[7] Separate Motions for Reconsideration filed by the petitioners were denied by the Court of Appeals.[8]

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[4] *Id.* at 589.

[5] *Id.* at 587.

[6] *Id.* at 569-570.

[7] *Id.* at 88.

[8] *Id.* at 90-95.

Supreme Court E-Library

Petitioners are now before the Court seeking a reversal of the decision of the Court of Appeals by arguing primarily that the Court of Appeals erred: a) in ruling that income tax paid by MERALCO should be treated as part of its operating expenses and thus considered in determining the amount of increase in rates imposed by MERALCO and b) in rejecting the *net average investment method* used by the COA and the ERB and instead adopted the *average investment method* used by MERALCO.

We grant the petition.

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. 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. Submission to regulation may be withdrawn by the owner by discontinuing use; but as long as use of the property is continued, the same is subject to public regulation.[9]

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. However, the power to regulate rates does not give the State the right to prescribe rates which are so low 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 the services rendered.*[10] The fixing of just and reasonable rates involves a *balancing* of the investor and the consumer interests.[11]

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[9] *Munn v. People of the State of Illinois*, 94 U.S. 113, 126 (1877).

[10] IV A. F. Agbayani, *Commentaries and Jurisprudence on the Commercial Laws of the Philippines* 500 (1993).

[11] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591.

Supreme Court E-Library

In his famous dissenting opinion in the 1923 case of *Southwestern Bell Tel. Co. v. Public Service Commission*,[12] Mr. Justice Brandeis wrote:

"The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in an enterprise. Upon the capital so invested, the Federal Constitution guarantees to the utility the opportunity to earn a *fair return*. . . The Constitution does not guarantee to the utility the opportunity to earn a return on the value of all items of property used by the utility, or of any of them.

. . . . . .

The investor agrees, by embarking capital in a utility, that its *charges to the public shall be reasonable. His company is the substitute for the State in the performance of the public service, thus becoming a public servant.* The compensation which the Constitution guarantees an opportunity to earn is the reasonable cost of conducting the business."

While the power to fix rates is a legislative function, whether exercised by the legislature itself or delegated through an administrative agency, 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.[13]

The ERB was created under Executive Order No. 172 to regulate, among others, the distribution of energy resources and to fix rates to be charged by public utilities involved in the distribution of electricity. In the fixing of rates, the *only standard* which the legislature is required to prescribe for the guidance of the administrative authority is that the *rate be reasonable and just*. It has been held that even in the absence of an express requirement as to reasonableness, this standard may be implied.[14]

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[12] 262 U.S. 290-91, 43 S.Ct. 544, 547 (1923).

[13] IV A. F. Agbayani, *Commentaries and Jurisprudence on the Commercial Laws of the Philippines* 500 (1993), citing *Ynchausti SS Co. v. Public Utility Commission*, 42 Phil. 624 and *Manila Electric Co. v. De Vera, et al.*, 66 Phil 161.

[14] *Philippine Communications Satellite Corporation v. Alcuaz, et al.*, 180 SCRA 218, 226 (1989).

Supreme Court E-Library

What is a just and reasonable rate is a question of fact calling for the exercise of discretion, good sense, and a fair, enlightened and independent judgment. The requirement of reasonableness comprehends such rates which must not be so 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 of the utility.[15]

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.[16] In one case,[17] we cautioned that courts should "refrain from substituting their discretion on the weight of the evidence for the discretion of the Public Service Commission on questions of fact and will only reverse or modify such orders of the Public Service Commission when it really appears that the evidence is insufficient to support their conclusions."[18]

In the cases at bar, findings and conclusions of the ERB on the rate that can be charged by MERALCO to the public should be respected.[19] 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

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[15] *Id.* at 232.

[16] *Casa Filipina Realty Corporation v. Office of the President*, 241 SCRA 165 (1995).

Substantial evidence is more than a mere scintilla. It means such relevant evidence which a reasonable mind might accept as adequate to form a conclusion. (*Ang Tibay v. Court of Industrial Relations*, 69 Phil. 635 (1940).

[17] *Batangas Transportation Company, et al. v. Laguna Transportation Company*, 104 Phil. 992 (1958).

[18] *Id.*, citing *Manila Yellow Taxicab Co. and Acro Taxicab Co. vs. Danon*, 58 Phil. 75 (1933).

[19] *Province of Zamboanga del Norte v. Court of Appeals*, 342 SCRA 549, 560 (2000).

Supreme Court E-Library

agency is unlawful or unreasonable.[20] 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 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.[21]

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; b) rate base; 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.[22] The rate of return 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.[23] The rate of return of a public utility is not prescribed by statute but by administrative and judicial pronouncements. This Court has consistently adopted a 12% rate of return for public utilities.[24] The rate base, on the other hand, 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.[25]

In the cases at bar, the resolution of the issues involved hinges on the determination of the kind and the amount of operating expenses that should be allowed to a public utility

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[20] *City of Cincinnati v. Public Utilities Commission*, 90 N.E. 2d 681 (1950).

[21] A. Sibal, *Administrative Law* 145 (1999).

[22] P. Garfield and W. Lovejoy, *Public Utility*, p. 116.

[23] Nichols and Welch, *Ruling Principles of Utility Regulations, Rate of Return, Supp. A*, 1 (1964).

[24] *Manila Electric Company v. Public Service Commission*, 18 SCRA 651, 665-666 (1966).

[25] Susan F. Fendell, *Public Ownership of Public Utilities: Have Stockholders Outlived Their Useful Economic Lives*? 43 Ohio St. L. J. 821 (1982); 64 Am Jur 2d § 138.

Supreme Court E-Library

to generate a fair return and the proper valuation of the rate base or the value of the property entitled to a return.

I

Income Tax as Operating Expense Cannot be Allowed For Rate-Determination Purposes

In determining whether or not a rate yields a fair return to the utility, the operating expenses of the utility must be considered. The return allowed to a public utility in accordance with the prescribed rate must be sufficient to provide for the payment of such reasonable operating expenses incurred by the public utility in the provision of its services to the public. Thus, the public utility is allowed a return on capital over and above operating expenses. However, only such expenses and in such amounts as are reasonable for the efficient operation of the utility should be allowed for determination of the rates to be charged by a public utility.

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 or are attributable 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."[26]

Income tax, it should be stressed, is imposed on an individual or entity as a form of excise tax or a tax on the privilege of earning income.[27] In exchange for the protection extended by

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[26] *Rollo*, G.R. No. 141314, p. 581.

[27] H. De Leon, *The Fundamentals of Taxation* 79 (1993).

Supreme Court E-Library

the State to the taxpayer, the government collects taxes as a source of revenue to finance its activities. Clearly, by its nature, income tax payments of a public utility are not expenses which contribute to or are incurred in connection with the production of profit of a public utility. Income tax should be borne by the taxpayer alone as they are payments made in exchange for benefits received by the taxpayer from the State. No benefit is derived by the customers of a public utility for the taxes paid by such entity and no direct contribution is made by the payment of income tax to the operation of a public utility for purposes of generating revenue or profit. *Accordingly, the burden of paying income tax should be Meralco's alone and should not be shifted to the consumers by including the same in the computation of its operating expenses.*

The principle behind the inclusion of operating expenses in the determination of a just and reasonable rate is to allow the public utility to recoup the reasonable amount of expenses it has incurred in connection with the services it provides. It does not give the public utility the license to indiscriminately charge any and all types of expenses incurred without regard to the nature thereof, *i.e.*, whether or not the expense is attributable to the production of services by the public utility. To charge consumers for expenses incurred by a public utility which are not related to the service or benefit derived by the customers from the public utility is unjustified and inequitable.

While the public utility is entitled to a reasonable return on the fair value of the property being used for the service of the public, no less than the Federal Supreme Court of the United States emphasized: "[t]he public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends. . . If a corporation cannot maintain such a [facility] and earn dividends for stockholders, it is a misfortune for it and them which the Constitution does not require to be remedied by imposing unjust burdens on the public."[28]

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[28] *Smyth v. Ames*, 169 U.S. 466, 545 (1898).

Supreme Court E-Library

We are not impressed by the reliance by MERALCO on some American case law allowing the treatment of income tax paid by a public utility as operating expense for rate-making purposes. Suffice to state that with regard to rate-determination, the government is not hidebound to apply any particular method or formula.[29] The question of what constitutes a reasonable return for the public utility is necessarily determined and controlled by its peculiar environmental milieu. Aside from the financial condition of the public utility, there are other critical factors to consider for purposes of rate regulation. Among others, they are: particular reasons involved for the request of the rate increase, the quality of services rendered by the public utility, the existence of competition, the element of risk or hazard involved in the investment, the capacity of consumers, *etc*.[30] Rate regulation is the art of reaching a result that is good for the public utility and is best for the public.

For these reasons, the Court cannot give in to the importunings of MERALCO that we blindly apply the rulings of American courts on the treatment of income tax as operating expenses in rate regulation cases. An approach allowing the indiscriminate inclusion of income tax payments as operating expenses may create an undesirable precedent and serve as a blanket authority for public utilities to charge their income tax payments to operating expenses and unjustly shift the tax burden to the customer. 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.[31] In the cases 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.

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[29] *Republic v. Medina*, 41 SCRA 643, 662 (1971); 64 Am Jur 2d 666.

[30] II O. Pond, *Public Utilities* 1037-1038 (1932).

[31] P. Garfield and W. Lovejoy, *Public Utility Economics* 386, 393 (1964).

Supreme Court E-Library

It is also noteworthy 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 a public utility depending on the state or locality where it operates. At a federal level, public utilities are subject to corporate income taxes and Social Security taxes — in the same manner as other business corporations. At the state and local levels, public utilities are subject to a wide variety of taxes, not all of which are imposed on each state. Thus, it is not unusual to find different taxes or combinations of taxes applicable to respective utility industries within a particular state.[32] A significant aspect of state and local taxation of public utilities in the United States is that they have been singled out for special taxation, *i.e.*, they are required to pay one or more taxes that are not levied upon other industries. In contrast, in this jurisdiction, public utilities are subject to the same tax treatment as any other corporation and local taxes paid by it to various local government units are substantially the same. The reason for this is that the power to tax resides in our legislature which may prescribe the limits of both national and local taxation, unlike in the federal system of the United States where state legislature may prescribe taxes to be levied in their respective jurisdictions.

MERALCO likewise cites decisions of the ERB[33] allowing the application of a tax recovery clause for the imposition of an additional charge on consumers for taxes paid by the public utility. A close look at these decisions will show they are *in appropos*. In the said cases, the ERB approved the adoption of a formula which will allow the public utility to recover from its customers taxes *already paid by it*. However, in the cases at bar, the income tax component added to the operating expenses of a public utility is based on an *estimate or approximate figure*

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[32] *Id.* at 385-386.

[33] *Cotabato Light & Power Plant* (ERB Case No. 91-70); *Davao Light and Power Co., Inc.* (ERB Case No. 92-105); and *San Fernando Electric Light and Power Co. Inc.* (ERB Case No. 97-11).

Supreme Court E-Library

of income tax to be paid by the public utility. It is this estimated amount of income tax to be paid by MERALCO which is included in the amount of operating expenses and used as basis in determining the reasonable rate to be charged to the customers. Accordingly, the varying factual circumstances in the said cases prohibit a square application of the rule under the previous ERB decisions.

II

Use of "Net Average Investment Method" is Not Unreasonable

In the determination of the rate base, property used in the operation of the public utility must be subject to appraisal and evaluation to determine the fair value thereof entitled to a fair return. With respect to those properties which have not been used by the public utility for the entire duration of the test year, *i.e.*, the year subject to audit examination for rate-making purposes, a valuation method must be adopted to determine the proportionate value of the property. Petitioners maintain that the *net average investment method* (also known as "actual number of months use method") recommended by COA and adopted by the ERB should be used, while MERALCO argues that the *average investment method* (also known as the "trending method") to determine the proportionate value of properties should be applied.

Under the "*net average investment method*," properties and equipment used in the operation of a public utility are entitled to a return only on the actual number of months they are in service during the period.[34] In contrast, the "average investment method" computes the proportionate value of the property by adding the value of the property at the beginning and at the end of the test year with the resulting sum divided by two.[35]

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[34] Section 608 (7), Article IX of the National Accounting and Auditing Manual.

[35] *Rollo* of G.R. No. 141314, p. 59.

Supreme Court E-Library

The ERB did not abuse its discretion when it applied the net average investment method. The reasonableness of net average investment method is borne by the records of the case. In its report, the COA explained that the computation of the proportionate value of the property and equipment in accordance with the *actual number of months* such property or equipment is in service for purposes of determining the rate base is favored, as against the trending method employed by MERALCO, "to reflect the real status of the property."[36] By using the net average investment method, the ERB and the COA considered for determination of the rate base the value of properties and equipment used by MERALCO in proportion to the period that the same were *actually used* during the period in question. This treatment is consistent with the *settled rule* in rate regulation that the determination of the rate base of 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.[37]

MERALCO does not seriously contest this treatment of actual usage of property but opposes the method of computation or valuation thereof adopted by the ERB and the COA on the ground that the net average investment method "assumes an ideal situation where a utility, like MERALCO, is able to record in its books within any given month the value of all the properties actually placed in service during that month."[38] MERALCO contends that immediate recordal in its books of the property or equipment is not possible as MERALCO's franchise covers a wide area and that due to the volume of properties and equipment put into service and the amount of paper work required to be accomplished for recording in the books of the company, "it takes three to six months (often longer) before an asset placed in service is recorded in the books" of MERALCO.[39]

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[36] *Id.* at 168.

[37] II O. Pond, *Public Utilities* 1154 (1932).

[38] Petition for Review, p. 22; *Rollo*, C.A.-G.R. No. 46888, p. 23.

[39] *Id.*

Supreme Court E-Library

Hence, MERALCO adopted the "average investment method" or the "trending method" which computes the average value of the property at the beginning and at the end of the test year to compensate for the irregular recording in its books.

MERALCO'S stance is belied by the COA Report which states that the "verification of the records, as confirmed by the Management Staff, disclosed that *properties are recorded in the books as these are actually placed in service.*"[40] Moreover, while the case was pending trial before the ERB, the ERB conducted an ocular inspection to examine the assets in service, records and books of accounts of MERALCO to ascertain the physical existence, ownership, valuation and usefulness of the assets contained in the COA Report.[41] Thus, MERALCO's contention that the date of recordal in the books does not reflect the date when the asset is placed in service is baseless.

Further, computing the proportionate value of assets used in service in accordance with the actual number of months the same is used during the test year is a more accurate method of determining the value of the properties of a public utility entitled to a return. If, as determined by COA, the date of recordal in the books of MERALCO reflects the actual date the equipment or property is used in service, there is no reason for the ERB to adopt the trending method applied by MERALCO if a more precise method is available for determining the proportionate value of the assets placed in service.

If we were to sustain the application of the "trending method," the public utility may easily manipulate the valuation of its property entitled to a return (rate base) by simply including a highly capitalized asset in the computation of the rate base even if the same was used for a limited period of time during the test year. With the inexactness of the trending method and the possibility that the valuation of certain properties may be subject to the control of and abuse by the public utility, the Court finds

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[40] *Rollo*, G.R. No. 141314, p. 168 (italics supplied).

[41] *Id.* at 560.

Supreme Court E-Library

no reasonable basis to overturn the recommendation of COA and the decision of the ERB.

MERALCO further insists that the Court should sustain the "trending method" in view of previous decisions by 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 on *stare decisis*.

Again, we are not impressed. It is a settled rule that the goal of rate-making is to arrive at a just and reasonable rate for both the public utility and the public which avails of the former's products and services.[42] However, what is a just and reasonable rate 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.[43] 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*.

At any rate, MERALCO has not adequately shown that the rates prescribed by the ERB are unjust or confiscatory as to deprive its stockholders a reasonable return on investment. In the early case of *Ynchausti S.S. Co. v. Public Utility Commissioner*, this Court held: "there is a legal presumption that the rates fixed by an administrative agency 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 an abuse of that discretion, the courts will not interfere."[44] Thus, the burden is

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[42] Rate-Making for Public Utilities, 169 SCRA 175, 192 (1989)

[43] 64 Am Jur 2d 666–667.

[44] 42 Phil. 621 (1922).

Supreme Court E-Library

upon the oppositor, MERALCO, to prove that the rates fixed by the ERB are unreasonable or otherwise confiscatory as to merit the reversal of the ERB. In the instant cases, MERALCO was unable to discharge this burden.

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 ₱0.017 per kilowatt hour, effective with respect to MERALCO's billing cycles beginning February 1994. Further, in accordance with the decision of the ERB dated February 16, 1998, the excess average amount of ₱0.167 per kilowatt hour starting with the applicant's billing cycles beginning February 1998 is ordered to be refunded to MERALCO's customers or correspondingly credited in their favor for future consumption.

SO ORDERED.

Panganiban, Sandoval-Gutierrez, Corona, and *Carpio-Morales, JJ.,* concur.

EN BANC

[G.R. Nos. 146464-67. November 15, 2002]

PEOPLE OF THE PHILIPPINES, *plaintiff-appellee, vs.* **JOSE VILLANUEVA,** *accused-appellant.*

SYNOPSIS

Appellant was found guilty of four counts of rape committed against his own minor daughter. He was sentenced to suffer the penalty of death and hence, this appeal.