

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



**IN THE MATTER OF THE  
PETITION FOR APPROVAL OF  
INTERIM OPEN ACCESS IN THE  
LUZON AND VISAYAS GRIDS**

**ERC CASE NO. 2008-026 RC**

**PHILIPPINE INDEPENDENT  
POWER PRODUCERS  
ASSOCIATION (PIPPA), MANILA  
ELECTRIC COMPANY  
(MERALCO), VISAYAN ELECTRIC  
COMPANY (VECO), CLARK  
ELECTRIC DISTRIBUTION CORP.  
(CEDC), DAVAO LIGHT & POWER  
CO. INC. (DLPC), CAGAYAN  
ELECTRIC POWER AND LIGHT  
COMPANY (CEPALCO), SAN  
FERNANDO ELECTRIC LIGHT &  
POWER CO. (SFELAPCO) and  
PANAY ELECTRIC COMPANY,  
INC. (PECO),**

**Petitioners.**

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**DOCKETED**  
Date: OCT 15 2009  
By: [Signature]

**ORDER**

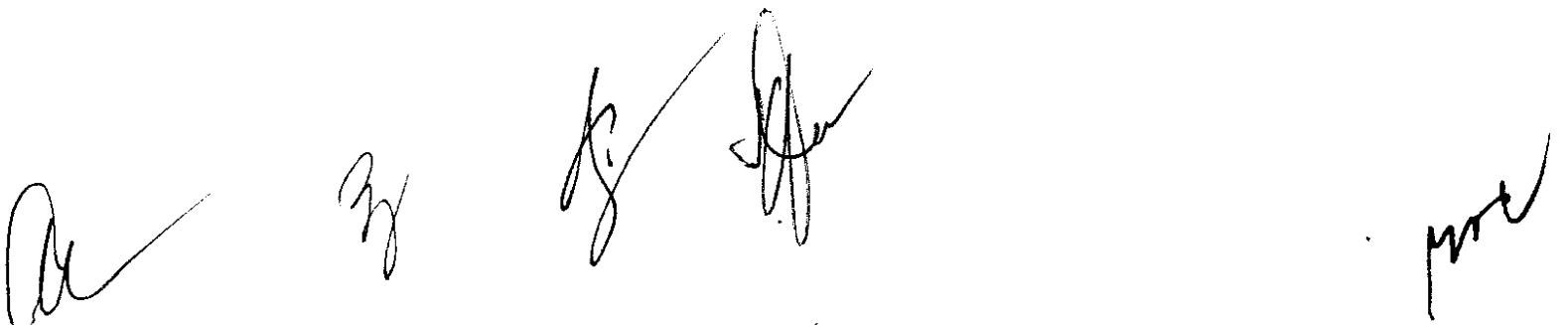
Before this Commission for resolution are the following:

1. "Motion for Partial Reconsideration/Clarification (with Entry of Appearance)" filed by the Manila Electric Company (MERALCO) on December 19, 2009, praying that the Decision dated November 10, 2008 be partially reconsidered or clarified as follows:

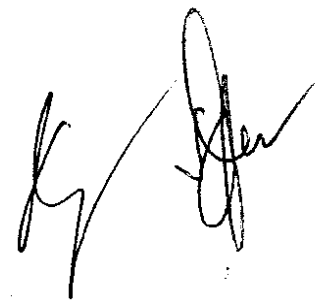
- a. Eligible DUs should be allowed to adjust the Transmission Supply Contract (TSC) contracted volumes for the movement of customers into and out of the Power Supply Option Program (PSOP) to ensure that it would have no detrimental effect on the customers of Distribution Utilities (DUs) not participating therein;
  - b. In the absence of express prohibition thereto, the participation of the DU's Local Retail Electricity Supplier (RES) as a potential Eligible Supplier for PSOP should be allowed; and
  - c. The treatment of distribution system losses should also be clarified.
2. The implementation date of the PSOP considering the aborted initiative to privatize the Calaca NPC Generation Assets.

In support of its motion, MERALCO averred, among others, that:

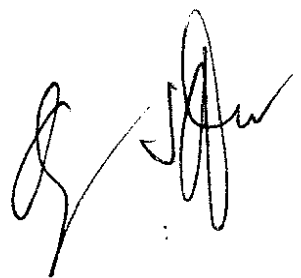
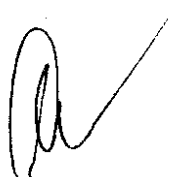
1. The inclusion of the automatic reduction of TSC volumes in the Terms of Reference (TOR) is for the purpose of ensuring that there would not be any adverse effect on the customers of the DU that would not be participating in the PSOP;
2. In the absence of a provision that would allow the automatic adjustment of contracted volumes in the TSC corresponding to the load of the customers participating in the PSOP and transferring to other suppliers, the DU may be exposed to contracted capacity it may no longer be able to sell given that the customer for which the energy was contracted is now taking energy through the PSOP;



3. Conversely, if a PSOP participant decides to exit from the program and return to the DU's regulated retail supply rates, the DU will be exposed to significant sourcing risks in sourcing additional, potentially more expensive, energy for the returning customer;
4. It is possible that the participation of customers in the PSOP will significantly reduce the wholesale energy requirement of the DU to supply its remaining (non-PSOP) customers. Should this occur, the TSC volume will be over and above what is required to serve its current customers and it cannot be said that the DU was imprudent in sourcing its activities considering that the TSCs were entered into at the time when there was yet no PSOP;
5. A common characteristic of all TSCs is that these are essentially take-or-pay arrangements. The contracted volumes have been committed to by the DUs with the full expectation that these will be consumed by all the customers in the franchise area for the term of the TSC, which is up to a period of one year from the introduction of open access;
6. With the implementation of the PSOP, not all volume contracted under the TSC may be consumed which would give rise to the possibility of incurring stranded costs, as any volume not consumed will still have to be paid for by the DUs as buyer and recovered from the customers as part of validly-incurred generation costs pursuant to Section 67 of R.A. No, 9136, otherwise known as the Electric Power Industry Reform Act of 2001 (EPIRA);
7. The stranded costs arising from what may appear to be over contracting should not be absorbed by the DUs or the captive customers not participating in the PSOP;
8. If the DUs will have to recover the stranded contract costs from the customers that participate in the PSOP, the recovery of the stranded costs may wipe out any savings that may arise from the relative competition introduced by the PSOP which would render the program useless;



9. The intent of DUs in participating in the PSOP is to allow customers to find lower-priced energy options. This should not lead to the DUs having to absorb stranded contract costs arising from customers choosing instead to participate in the PSOP nor should the DUs' customers not participating in the PSOP be made to absorb these costs;
10. The said costs would be forced upon the customers of the DUs to bear under the regulated retail rates, which is contrary to the principles underlying the PSOP;
11. The choice of a customer to enter into or exit from the PSOP is purely a business decision on its part and it would not be reasonable to expect that prudent sourcing on the part of the DUs involves accurately predicting a customer's choice to participate in or withdraw from PSOP;
12. In the absence of express prohibition, the participation of the DU's local RES as a potential eligible supplier for PSOP should be allowed;
13. The Decision states that an eligible supplier must have a RES license and, if the potential eligible supplier is a generator, it must fall within the EPIRA specified market caps for control of installed generation;
14. The additional functions of the eligible DUs during the PSOP do not conflict with the DUs' local RES being an eligible supplier;
15. The DUs will always have to demonstrate that each and every eligible supplier under the PSOP is treated fairly and in a non-discriminatory manner. The Business Separation Guidelines (BSG) in particular, would ensure that there will be no hidden cross-subsidies among electricity participants. The BSG would establish transactional firewalls both within and among electric power industry participants. This way, the provision of a non-regulated service (e.g. retail supply) remains as a business decision for the electric power participant, fostering an environment conducive for competition;

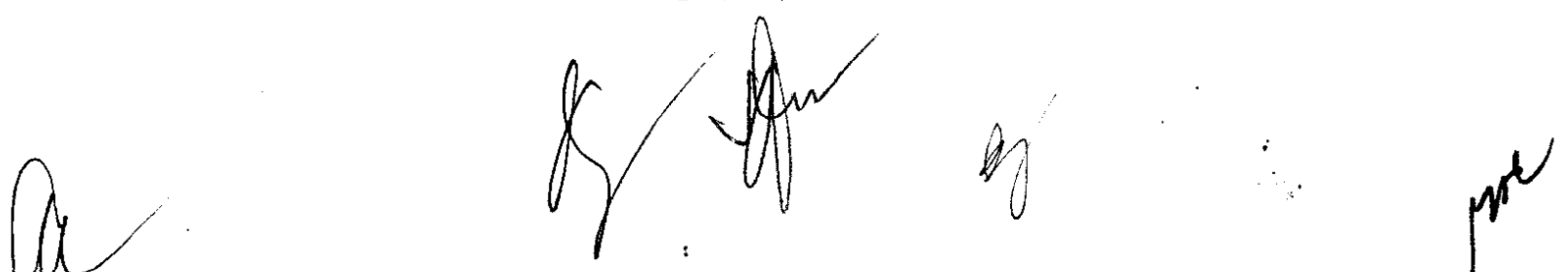


16. In its case, a number of customers have been inquiring on its intention to join the PSOP as a local RES;
17. The matter relating to the responsibility for distribution line losses need to be clarified whether or not the same are those incurred at the distribution or transmission level; and
18. There are no provisions in the Decision concerning the treatment of distribution line losses.

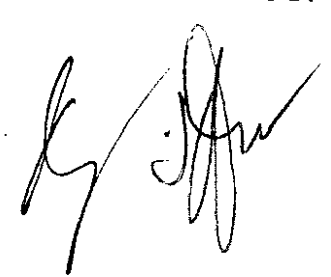
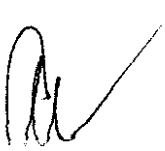
In an Order dated January 19, 2009, the Commission directed the parties to comment on MERALCO's motion.

On January 27, 2009, Masinloc Power Partners Co., Ltd. (AES Philippines) filed an "Ex Parte Manifestation" attaching therewith an advanced copy of the "Comment" it filed via registered mail on January 26, 2009. On the other hand, in its comment, AES Philippines alleged, among others, the following:

1. There is nothing in the assailed Decision that disallows the reduction of TSC volumes as the ruling of the Commission expressly allows the reduction of contracted volume in accordance with the provisions of the TSC;
2. It reiterates that the implementation of the PSOP cannot and should not modify existing TSCs without the agreement of the contracting parties as this will result in impairing the parties' contractual obligations which is proscribed under the Philippine Constitution;
3. As a rule, contractual agreements should be respected and not to be altered or modified by subsequent laws enacted by the legislature, executive orders, and administrative regulations that will change the intention of the parties or modify their rights and obligations;

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4. The TSCs may have varying provisions with respect to adjustments in the TSC volumes;
5. It agrees with the Decision that any adjustment in the TSC volume should conform to the relevant provisions thereof;
6. Implementing an automatic reduction in the TSC volume will result in an unjust and inequitable situation to the assignee of the TSC especially if the contestable customer of an Eligible DU will enter into a power supply contract with a different generation company other than the generation company which is the assignee of the TSC;
7. MERALCO's proposed solution of an automatic reduction, though ideal, may eventually give rise to more legal questions;
8. Instead, the following proposals are submitted for consideration of the Commission:
  - a. To allow the parties to renegotiate their volumes in such a manner that the commercial interest of either party would be maintained notwithstanding the transfer of the DUs' customers, the Commission may direct the Eligible DU and its power supplier to renegotiate on a resulting adjustment in the TSC contracted volume consequent to a DU's customer participating in the PSOP or arrive at an appropriate arrangement that will not unduly prejudice the interest of the parties to the contract; and
  - b. The parties would have to inform the Commission regarding the renegotiated or amended TSCs without the latter having to approve the same if the arrangement does not involve an amendment in the rates.
9. By directing the parties to renegotiate their TSCs, this would address the concerns of MERALCO and other Eligible DUs on the possibility of being exposed to contracted capacity that they would not be able to sell to customers who have availed of the PSOP.



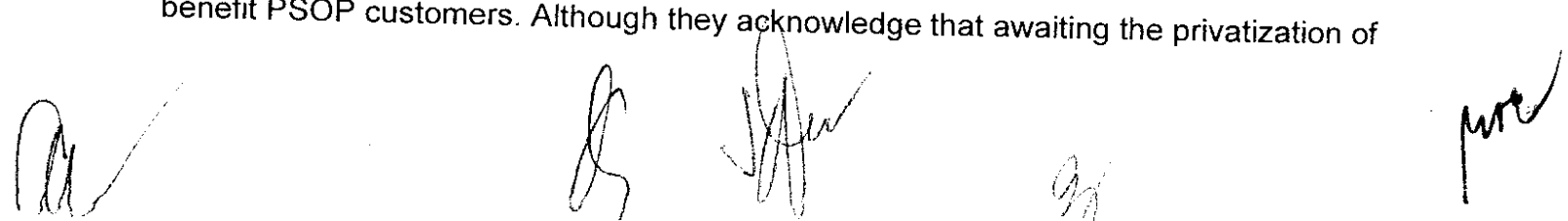
On January 29, 2009, the Power Sector Assets and Liabilities Management Corporation (PSALM) filed its "Manifestation" reiterating its position as reflected in its previously filed "Pre-trial Brief" dated June 12, 2008, "Petition to Intervene/Comment" dated June 12, 2008 and "Position Paper" dated June 19, 2008.

Meanwhile, on February 3, 2009 and February 4, 2009, the Petitioners and the Philippine Electricity Market Corporation (PEMC) filed their respective manifestations, posing no objection to MERALCO's motion.

In its Order dated March 12, 2009, the Commission sought the comment of the Petitioners relative to their intention to maintain, as a precondition for the implementation of the PSOP, the privatization of the Calaca NPC Generation Assets.

On March 27, 2009, AES Philippines filed its "Comment" positing that the failure of the privatization of the Calaca Power Plant should not be a hindrance to the implementation of the PSOP. As an alternative, it proposed as precondition for the implementation of the PSOP the privatization of the Tiwi-MakBan geothermal facilities and justified that its inclusion will give a better assurance of actual competition as the capacity of said plant, at 745 MW, is higher than the 600 MW capacity of the Calaca Power Plant.

On April 7, 2009, Petitioners jointly filed their "Comment" stating therein that the privatization of the Calaca NPC Generation Assets should be maintained as a precondition to the implementation of the PSOP pursuant to its TOR. According to the Petitioners, the said privatization would realize their envisioned genuine competition based on increased number of eligible generation companies, which shall ultimately benefit PSOP customers. Although they acknowledge that awaiting the privatization of

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the Calaca NPC Generation Assets may consequently delay the implementation of the PSOP, they believe, however, that the resulting competition in the market far outweighs any delay.

To facilitate the resolution of pending issues, the Commission issued an Order on June 25, 2009 directing all the parties to comment on whether or not the privatization of at least 70% of the total capacity of NPC Generating Assets in Luzon and Visayas, in lieu of the transfer of the operation of the Calaca Privatized NPC Generation Assets, is an acceptable precondition to the implementation of the PSOP.

In compliance with the foregoing, PSALM filed its "Manifestation" on July 7, 2009 maintaining its comments in its previously filed "Pre-trial Brief", "Petition to Intervene/Comment" and "Position Paper."

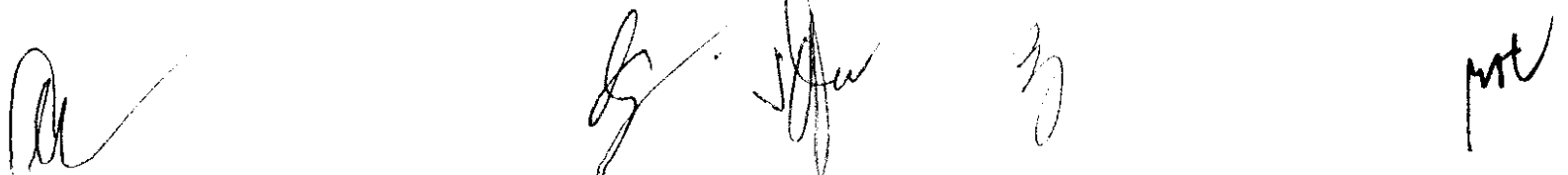
Meanwhile, AES Philippines manifested in the "Comment" it filed on July 13, 2009 that it was amenable to the imposition of the new precondition and reiterated the suggestions advanced in its prior "Comment" filed on March 27, 2009.

Petitioners filed their "Comment" on July 23, 2009 where they posed no objection to the imposition of the new precondition.

## DISCUSSION

### MERALCO's MOTION FOR PARTIAL RECONSIDERATION and CLARIFICATION

#### 1. Reduction of TSC Volumes:



The supply scheme proposed by MERALCO permits the automatic modification of the TSCs, either by way of increase or decrease in contracted volumes whichever the circumstance requires without the consequent payment of penalty or buy-out fee on the part of the DU in situations where its customer avails the PSOP.

By way of background, all TSCs between the NPC and DUs contain a buy-out provision, wherein the DU is subjected to a buy-out or pre-termination fee should it reduce its contracted volume or pre-terminate the TSC. The TSC only allows for the non-payment of the buy-out fee for reductions attributable to open access and retail competition. Since the PSOP is simply a choice of power supply, the reduction of TSC volumes due to customers' availing of the program will subject the concerned DU to the buy-out-fee.

On the other hand, MERALCO's TSC has features distinct from the TSCs of other DUs, such that reduction is allowed upon open access, as a result of the transfer by a MERALCO customer to NPC or to any other supplier. The said provision states:

"5.3. MERALCO shall also be allowed to reduce its monthly contracted energy by serving a written notice to NPC at least ten (10) and sixty (60) days prior to the effectivity of such reduction. Such reduction in contract energy shall be allowed to MERALCO and reflected as a corresponding reduction in the monthly contracted energy by an equivalent quantity of energy as a result of any of the following:

- a) Upon open access, a transfer by a MERALCO customer to NPC or to any other supplier; and
- b) Disconnection of service or termination of the electric service contract due to business closure of commercial/industrial customer of MERALCO."

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Considering that the PSOP is not yet the open access envisioned in the EPIRA, as clearly distinguished in the assailed Decision of November 10, 2008, situations akin to those mentioned by MERALCO in its motion are not covered by the conditions stated in its TSC where it may avail itself of the exceptions adverted to in the above-quoted TSC stipulation. Apropos, the Commission unequivocally ruled in the said Decision that reduction in TSC quantities may be made in accordance with the provisions of the TSC or as otherwise agreed upon by the parties.

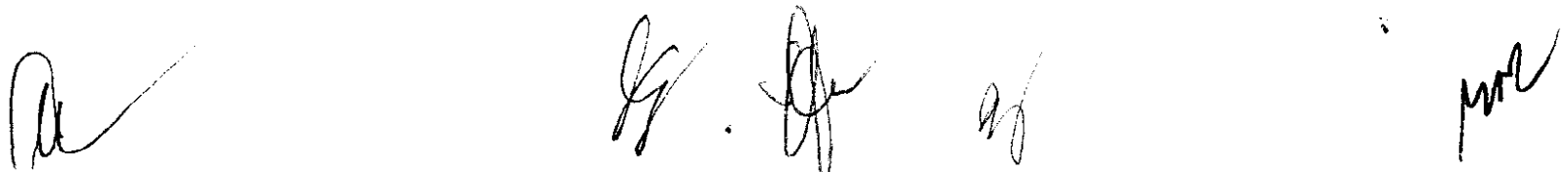
The Commission stands firm in this since the PSOP is voluntary in nature and it deems TSCs to be valid bilateral contracts between the parties which are protected by the doctrine on sanctity and inviolability of contracts. Thus, the implementation of the PSOP cannot and should not modify existing TSCs unless modified or amended by agreement of the contracting parties.

Moreover, there is no legal impediment which may preclude the contracting parties from renegotiating the contracted volumes once the PSOP is implemented. Therefore, the parties should, instead, renegotiate on a resulting adjustment of their TSC contracted volume and/or bilateral contract based on their forecasts and submit the contract with renegotiated quantities to the Commission for its approval.

## **2. The participation of the DUs Local RES as Eligible Supplier**

MERALCO argues that there is nothing in the assailed Decision that prohibits the participation of the Local RES as a potential Eligible Supplier for PSOP.

In the Decision dated November 10, 2008, the Commission ruled that Eligible Suppliers shall include generation companies (GenCos), including those that acquired the privatized NPC generation assets that are within the mandated cap. These GenCos

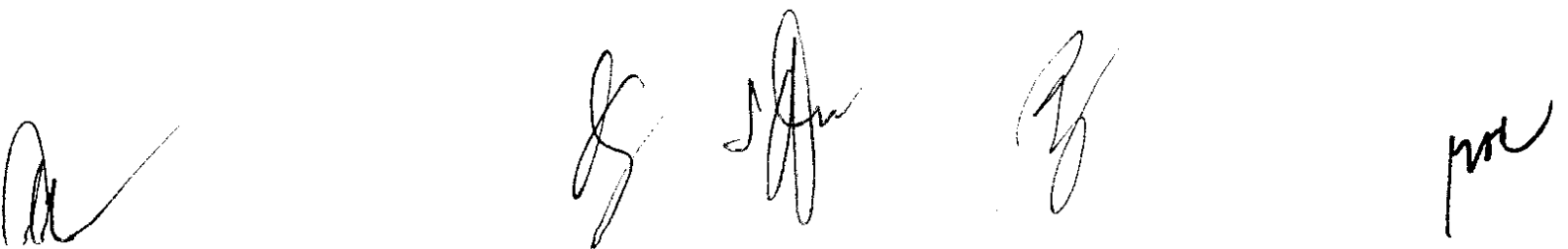
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are required to secure RES license prior to participation in the PSOP. Further, inasmuch as the Commission already issued licenses to several power suppliers which intend to supply during actual open access and retail competition, it determined that the existing licensed RES should be allowed to sell under the PSOP.

The Commission has evaluated and studied the Petition and the subsequent hearings conducted thereafter and it is clear that there was no intention at the outset to include the Local RES. The Local RES is the non-regulated retail service business segment of a DU which provides services relating to the sale of electricity to contestable customers as provided in the BSG, as amended. The PSOP scheme is based primarily on the framework submitted by Petitioners as embodied in their TOR. Any modifications made by the Commission were mainly in the form of additions for purposes of clarifying or curing defects in the program.

There is no cogent reason to allow the Local RES to operate under the PSOP inasmuch as all customers of the DUs within their franchise areas remain captive customers and the rates to be implemented would still have to be approved and regulated by the Commission. On the other hand, the PSOP is designed to give customers the option to choose their supplier of electricity. The power rate or the generation charge to be implemented to PSOP customers shall not be subject to the Commission's approval.

Thus, MERALCO or other DUs are not prohibited from participating in the PSOP as Eligible Suppliers provided that they obtain the necessary license and maintain their Eligible Customers outside their respective franchise areas.



### 3. Treatment of Distribution System Losses

Anent the clarification regarding the accounting and treatment of distribution system losses for participants of the PSOP, Sec. 5.4, Article V of the Distribution Service Open Access Rules (DSOAR) provides:

“xxx Connection customers and the DU shall handle system losses in accordance with the Commission’s rules and regulations. An RES and End-users in the Contestable Market purchasing DWS from the DU shall also pay any applicable distribution System Loss Charge and shall not be responsible for procuring energy to cover distribution system losses. The DU is responsible for procuring all energy related to distribution system losses and will be allowed to recover such costs through ERC approved System Loss Charges, subject to a System Loss Cap.”

The Draft Rules for the PSOP issued by the Commission provides that “The Eligible DU shall be responsible for procuring all energy related to distribution system losses, as provided for under Section 5.4, Article V of the Distribution Service Open Access Rules (DSOAR). The system loss charges should be based on blended purchased power costs of the Eligible DU and shall be based on the ERC-approved rates.” The said provision adequately addresses the issue raised by MERALCO on this subject. Absent any issue on the foregoing, the same shall be maintained.

### PRIVATIZATION AS A PRE-CONDITION TO PSOP

Among the preconditions provided in the Decision prior to the implementation of the PSOP is the privatization of the Calaca NPC Generation Assets. This is based on the Petitioners’ proposal that interim open access shall take effect only upon the transfer of the operation of the Calaca and Masinloc NPC Generation Assets to the private generation companies concerned.

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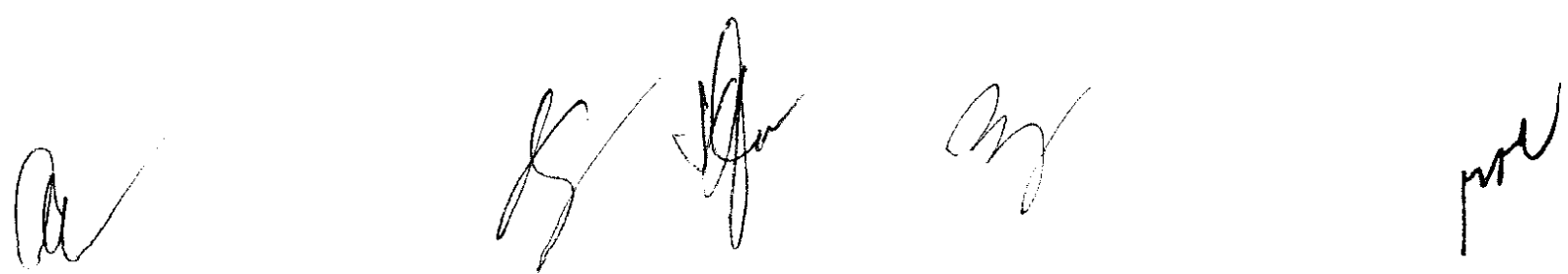
Mitigating measures and other similar safety nets will be established by the Commission prior to the implementation of PSOP. One of the measures is to ensure that there will be a level-playing field with sufficient participants in the PSOP where no dominant players enjoy undue advantage.

In line with this, the Commission takes judicial notice of the prospective sale and transfer of the Calaca NPC Generation Assets which could actually increase the number of competing entities in the PSOP should the winning bidder be a new player.

The sale of the Calaca power facility would result in the availability of a substantial amount of uncontracted capacity. To date, 72.19% of the aggregate capacity in Luzon and Visayas has successfully been bidded-out as of August 2009, and 56.98% has been fully paid and turned over to the new owners.

The presence of either condition would sufficiently promote the envisioned competition in the implementation of the PSOP.

**WHEREFORE**, the foregoing premises considered, the "Motion for Partial Reconsideration/Clarification (with Entry of Appearance)" filed by the Manila Electric Company (MERALCO) is hereby **GRANTED** only on the clarification sought on the accounting and treatment of distribution system losses for participants of the PSOP. The reconsideration sought relating to the automatic adjustment of the Transition Supply Contract (TSC) contracted quantities and the inclusion of the Local Retail Electricity Supplier (RES) in the Power Supply Option Program (PSOP) are hereby **DENIED** for lack of merit.

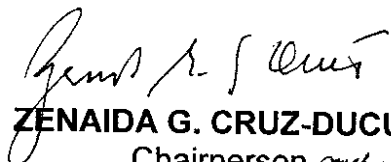


Accordingly, the PSOP shall commence ninety (90) days after completion of either of the following conditions, whichever comes earlier:

- a. The transfer of the operation of the Calaca NPC Generation Assets to the private generation companies concerned or its equivalent in terms of capacity; or
- b. The privatization of at least 70% of the total capacity of generating assets of NPC in Luzon and Visayas,

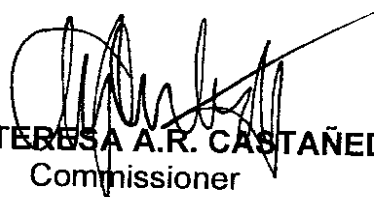
**SO ORDERED.**

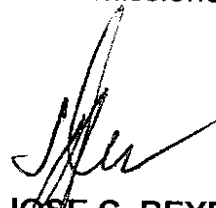
Pasig City, September 14, 2009.

  
**ZENaida G. CRUZ-DUCUT**  
Chairperson *gmdc*

  
**RAUF A. TAN**  
Commissioner

  
**ALEJANDRO Z. BARIN**  
Commissioner

  
**MARIA TERESA A.R. CASTAÑEDA**  
Commissioner

  
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