

Republic of the Philippines
Energy Regulatory Commission
San Miguel Avenue, Pasig City



IN THE MATTER OF THE APPLICATION
FOR THE APPROVAL OF THE PRICING
AND COST RECOVERY MECHANISM
(PCRM) FOR RESERVES IN THE
PHILIPPINE WHOLESALE ELECTRICITY
SPOT MARKET (WESM)

ERC CASE NO. 2007-004 RC

PHILIPPINE ELECTRICITY MARKET
CORPORATION (PEMC),

Applicant.

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DOCKETED
Date: JAN 03 2012
By: _____

ORDER

On November 15, 2010, the Commission issued an Order directing the Philippine Electricity Market Corporation (PEMC) to submit, among others, measures to mitigate market power in the reserve market.

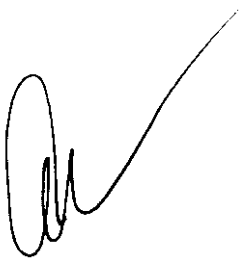
On August 1, 2011, PEMC filed its "Compliance" entitled "Market Power Mitigating Measures Study for the Wholesale Electricity Spot Market (WESM) Reserves Market" which enumerated several possible mitigating measures to minimize incentives for exercising market power.

In its study, PEMC initially discussed that in general, market power is the ability of a single market participant or group of competing market participants in a market to profitably raise prices above competitive levels and restrict output below competitive levels for a sustained period of time. The ability to have market power may exist because of: a) large market share; b) system security constraints; c) tight supply conditions; or d) a combination of these conditions.

PEMC also stated that structural defects in the market, which may lead to potential market power include: a) lack of demand response; b) lack of sufficient forward contracting; and c) lack of new players in the market. As such, market power mitigation mechanisms are essential in an electricity market to ensure that customers/end-users benefit from power industry deregulation and to allow the efficient operation of the market.

PEMC added that there are already mitigating measures being employed in the WESM energy market which can be applied in the proposed WESM reserves market given that these are integral parts of the electricity market, such as: a) Maximum Market Share Level; b) Rules Change Process; and c) Pre-emptive Measures (Bid/Offer Cap and Price Substitutions).

Nonetheless, PEMC presented the following pre-emptive market power mitigating measures to be considered in the reserves market that would require adjustments on the Market Management System (MMS) settings and/or market procedure:



A. Application of Bid/Offer Cap (Offer Price Ceiling)

In the absence of historical market-based pricing for reserves, the reserve bid or offers cap can be initially set to the current energy offer cap of Php62,000/kWh. This is logical as the reserve provider will ultimately provide energy if the reserve capacity is actually utilized. Such cap can be reviewed and reset after six (6) months of reserve trading, subject to appropriate market procedures and regulatory approvals.

Another option is to have a selective application of reserve bid/offer caps to units that have potential for market power based on historical energy trading market monitoring index results. The reserve bid/offer cap for the identified unit can be determined based on a cost formula or previously approved contract price level with the System Operator.

B. Application of Market Clearing Price Cap/Ceiling

A cap on the resulting reserve market clearing price set at a level which still allows the reflection of scarcity when shortages of operating reserves occur. This can be implemented (substituted) in the settlement system for reserve market clearing prices which are deemed unreasonable.

C. Automatic Default Reserve Price Substitution Mechanism

A high or unreasonable reserve market clearing price can be mitigated based on an agreed formula. A trigger mechanism may be used based on set criteria that are pre-agreed or have been approved by the Commission. The price substitution process may be applied when there are significant infrastructure problems in the market, e.g., sustained tight reserve conditions, loss of hydropower or major transmission line outages.



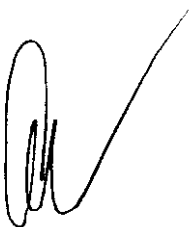
In the California energy market, for instance, mitigating measures are applied to dispatch levels exceeding acceptable limits. If applied in the reserve market, dispatch levels exceeding acceptable limits may be settled using several options such as: 1) default bids as submitted by market participants; 2) the Time of Use (TOU) rates; and 3) the Generation Price Index (GPI) formulation similar to the Must Run Unit (MRU) methodology with certain adjustments to reflect competitive pricing.

In addition to the foregoing, PEMC offered additional mitigating measures that can be incorporated in the design of the reserves market which may require, aside from MMS adjustments and Rules changes, policy setting from the Department of Energy (DOE) and/or the Commission, and amendments to relevant Rules and Regulations. These are: a) Bilateral Contract Reserve; b) Vesting Contracts for Generators; c) Increased Demand Side Participation (Interruptible Load Dropping); d) Ensuring Adequacy of Reserve Requirements; and e) Forwards Contracts.

PEMC averred that the participation from the customer side in setting the prices in the market will provide a full counter-measure to the generators' potential to exercise market power.

The Commission agrees with PEMC's position that ensuring supply adequacy and forwards contracts are long-term options that would require not just development of the market or the MMS but also the development of the power industry as well.

On the matter of increasing demand side participation through interruptible load dropping, the Commission posits that it is already part of the directed operational enhancements in the present case.



The Commission is particularly keen on pursuing the proposed Automatic Default Reserve Price Substitution Mechanism (Mechanism). Bid/offer and price caps would be unnecessary if this Mechanism is in place. It is expected that the market participants would adjust their behavior in view of a predetermined trigger price that would prevent high or unreasonable reserve market clearing prices. Moreover, this Mechanism must also be applied to the energy market to address the unreasonable past market results that usually follow market events such as tight supply conditions.

Although this would require a lengthy consultation process, the Commission believes that the resulting Mechanism would definitely reduce the potential of misuse of market power. Among others, this would spare the public from being exposed to unreasonable price increases and instill discipline among market participants to act in accordance with market rules and regulations. This would ultimately minimize, if not eliminate, contentious investigation and legal proceedings against anti-competitive behavior or misuse of market power. Furthermore, although volatile market prices cannot be totally avoided, the adoption of this Mechanism will reduce the variance of price fluctuations. The increased price stability will lead to a favorable investment climate.

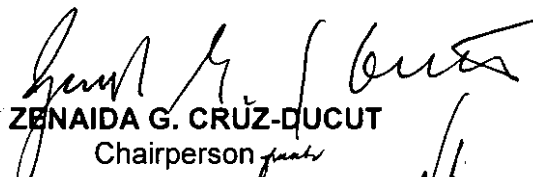
In view of the foregoing, PEMC is hereby directed to formulate and submit to the Commission, within three (3) months from receipt hereof, the Automatic Default Reserve Price Substitution Mechanism to be applied not only to the Reserve Market but to the Energy Market as well.

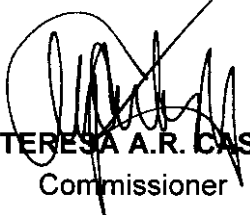


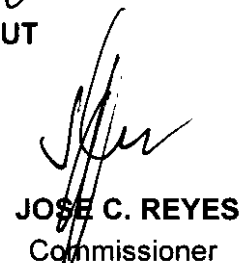
In the meantime, the Commission takes note of PEMC's "Manifestation and Motion (Re: Issuance of Order Directing Participation and Compliance by NGCP)", filed on September 26, 2011.

SO ORDERED.

Pasig City, October 17, 2011


ZENAIDA G. CRUZ-DUCUT
Chairperson *quasi*


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Commissioner


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