

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

**GUIDELINES FOR THE RECOVERY OF COSTS FOR THE GENERATION
COMPONENT OF THE DISTRIBUTION UTILITIES' RATES**

Pursuant to Sections 25 and 67 of Republic Act No. 9136 or "the Act" and Part II, Rule 5, Section 6 of the Implementing Rules and Regulations (IRR) of the Act, the Energy Regulatory Commission (ERC) hereby adopts and promulgates this guidelines:

(a) To establish the process for determining when the recovery of the generation component of the supply of electricity in the Retail Rates of a Distribution Utility should be limited by the rate contained within the Transition Supply Contract ("TSC");

(b) To establish procedures, standards and criteria for the full recovery of prudent and reasonable economic costs related to the generation component included in the Retail Rates charged by Distribution Utilities for the supply of electricity to their Captive Market; and

(c) To establish guidelines for the approval of new generation contracts by the ERC.

ARTICLE I

GENERAL PROVISIONS

This Guidelines shall have the following objectives:

(a) To ensure the continued quality, reliability, security and affordability of the supply of electric power;

(b) To ensure the transparent and reasonable prices of electric service in a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency;

(c) To enhance the inflow of private capital and broaden the ownership base in the power generation sector of the industry; and

(d) To encourage the efficient use of energy and other modalities of demand side management.

ARTICLE II

SCOPE AND DEFINITION OF TERMS

Section 1. Scope – This Guidelines shall apply to:

- (a) National Power Corporation;
- (b) Generation Companies, excluding SPUG;
- (c) National Transmission Corporation;
- (d) Power Sector Assets and Liabilities Management Corporation;
- (e) Department of Energy;
- (f) Distribution Utilities; and
- (g) Combinations of Distribution Utilities.

Section 2. Definition of Terms - As used in this Guidelines, the following terms shall have the following respective meanings:

(a) **“Act”** unless otherwise stated, shall refer to Republic Act No. 9136, otherwise known as the “Electric Power Industry Reform Act of 2001”;

(b) **“Captive Market”** shall refer to electricity end-users who do not have the choice of a supplier of electricity, as may be determined by the Energy Regulatory Commission (ERC) in accordance with the Act;

(c) **“Certificate of Compliance”** shall refer to the document issued by the ERC to a Generation Company pursuant to the Act, the Implementing Rules and Regulations of the Act and the applicable ERC Guidelines;

(d) **“Contestable Market”** shall refer to electricity end-users who have choice of a supplier of electricity, as may be determined by the ERC in accordance with the Act;

(e) **“Department of Energy” or “DOE”** shall refer to the government agency created pursuant to Republic Act No. 7638 which is provided with the additional mandate under the Act of supervising the restructuring of the electricity industry, developing policies and procedures, formulating and implementing programs, and promoting a system of incentives that will encourage private sector investments and reforms in the electricity industry and ensuring an adequate and reliable supply of electricity;

(f) **“Demand Side Management” or “DSM”** shall refer to measures undertaken by Distribution Utilities to encourage end-users in the proper management of their load to achieve efficiency in the utilization of fixed infrastructures in the system;

(g) **“Distribution Utility”** shall refer to any electric cooperative, private corporation, government-owned utility or existing local government unit which has an exclusive franchise to operate a distribution system in accordance with its franchise and the Act;

(h) **“Energy Regulatory Commission” or “ERC”** shall refer to the regulatory agency created by Section 38 of the Act;

(i) **“Generation Company”** shall refer to any person or entity authorized by the ERC to operate facilities used in the generation of electricity;

(j) **“Generation Rate Adjustment Mechanism (GRAM)”** shall refer to the mechanism which allows the periodic adjustment to the Generation Rate to reflect changes in fuel and purchased power costs after a review by the ERC before costs are passed on to customers;

(k) **“Grid”** shall refer to the high backbone system of interconnected transmission lines, substations and related facilities;

(l) **“Incremental Currency Exchange Rate Adjustment (ICERA)”** shall refer to the mechanism which allows the periodic adjustment to the FOREX Adjustment/CERA to reflect the changes in currency exchange after a review by the ERC before said changes are passed on to customers;

(m) **“National Power Corporation” or “NPC”** shall refer to the government corporation created under Republic Act No. 6395, as amended;

(n) **“National Transmission Corporation or TRANSCO”** shall refer to the corporation organized pursuant to the Act to acquire all the transmission assets of the NPC;

(o) **“Power Development Program” or “PDP”** shall refer to the indicative plan for managing electricity demand through energy-efficient programs and for the upgrading, expansion, rehabilitation, repair and maintenance of power generation and transmission facilities, formulated and updated yearly by the DOE in coordination with the generation, transmission and distribution utility companies;

(p) **“PSALM Corporation” or “PSALM” or “Power Sector Assets and Liabilities Management Corporation”** shall refer to the Government – owned and controlled corporation created pursuant to Section 49 of the Act, which took ownership of all existing NPC generation assets, liabilities, IPP contracts, real estate, and all other disposable assets;

(q) **“Region”** shall refer to the three (3) separate Grids, namely Luzon, Visayas and Mindanao;

(r) **“Regional Rate Schedule”** shall refer to the schedule of rates, including adjustments and/or indexation formulas, contained within the TSCs offered by NPC for each Region;

(s) **“Regional TSC Availability Record”** shall refer to the record created and updated pursuant to Section 1, Article IV;

(t) **“Retail Rate”** shall refer to the total price paid by end-users consisting of the charges for generation, transmission and related ancillary services, distribution, supply and other related charges for electric service;

(u) **“Supplier”** shall refer to any Person licensed by the ERC to sell, broker, market or aggregate electricity to end-users; and

(v) **“Transition Supply Contract” or “TSC”** shall refer to a contract for electricity supply filed with the ERC by NPC in accordance with Section 67 of the Act.

ARTICLE III

NPC TRANSITION SUPPLY CONTRACTS

Section 1. Filing and Approval of Supplemental Agreements for Existing NPC Supply Contracts - Not later than thirty (30) days following the effectivity of this guidelines NPC shall file with the ERC the supplementary agreements for existing executed power supply contracts with Distribution Utilities. The supplemental agreements shall include, at the minimum, the term of the supplemental agreement, the quantity of capacity and energy being contracted and the regional rate schedule. The ERC shall act on the supplemental agreement within sixty (60) days from the acceptance of the filing.

Section 2. NPC’s Offering of New TSCs to Distribution Utilities – Not later than sixty (60) days following the effectivity of this guidelines NPC shall offer TSCs to all Distribution Utilities in each Region subject to availability and in accordance with Section 4, Article III.

Section 3. Initial Requests by Distribution Utilities for TSCs - Not later than thirty (30) days following the offer from NPC of a TSC, the Distribution Utility shall submit a letter of intent to enter into a TSC with NPC to the Office of the President of NPC and the Office of the President of PSALM. The Distribution Utility shall simultaneously provide a copy to ERC on all letters of intent. A letter of intent shall include the hourly schedule of demand and energy, if available, during the term of the TSC, with as much detail or specificity as possible, for which the Distribution Utility intends to contract.

Section 4. Allocation of TSCs within each Region – In the event that NPC lacks sufficient capacity and/or energy in any Region to fulfill all the requests for TSCs in that Region as evidenced by the letters of intent received pursuant to Section 4 above, each Distribution Utility requesting a TSC shall have its request reduced prorata with all other requests for TSCs in that Region.

Section 5. Filing and Approval of an Executed TSC – NPC shall file with the ERC, for its approval, all TSCs duly negotiated and executed with any Distribution Utility. The ERC shall issue their final approval of such TSCs within ninety (90) days following acceptance of the filing.

ARTICLE IV

RECOVERY OF COSTS FOR THE GENERATION COMPONENT OF THE SUPPLY OF ELECTRICITY IN THE RETAIL RATE FOR THE TERM OF THE TRANSITION SUPPLY CONTRACT

Section 1. Record of Available TSCs by Region - Not later than thirty (30) days following the effectivity of this guidelines, NPC and TRANSCO shall jointly file, for each Region, an initial Regional TSC Availability Record. Such filing shall include by Region:

(a) the total NPC generation capacity and energy eligible for TSCs pursuant to Section 67 of the Act including limitations due to fuel supply, if any, for a period of time equivalent to the term of the proposed or executed TSCs;

(b) all transmission limitations including, but not limited to, the maximum transfer capability to each potential buyer in each region within applicable system reliability and security parameters;

(c) the generation capacity and energy taken up by executed TSCs, supplemental agreements to TSCs and any other contractual agreements of NPC;

(d) the generation capacity and energy expected to be taken up by pending TSCs; and

(e) the generation capacity and energy still available to Distribution Utilities under TSCs.

The filing shall include all supporting data, documentation, calculations, and analyses, operating levels, security constraints and ancillary services requirement. Such filing shall be certified by the Department of Energy (DOE). Within six (6) months of the filing of the initial Regional TSC Availability Record, and every six (6) months thereafter during the term of the TSCs, NPC and TRANSCO shall file an updated Regional TSC Availability Record duly certified by the DOE.

Section 2. Primary Limitation on the Recovery of Costs through the Retail Rates - For the term of the TSCs, the recovery of costs by a Distribution Utility for the generation component of their supply of electricity in their Retail Rate shall be limited to the applicable Regional TSC Rate: *Provided*, That an equivalent quality and quantity of electricity is still available to the Distribution Utility under the applicable regional TSC as demonstrated by the Regional TSC Availability Record. In determining the appropriate limitation on recovery of costs of the generation component in the Retail Rates, the applicable Regional TSC rate shall be for the same period as the generation capacity and energy arrangement for which the Distribution Utility is seeking recovery of costs in the Retail Rate. The recovery of costs incurred by a Distribution Utility for any generation component in excess of the applicable TSC Regional Rate, as updated shall be disallowed by ERC, except for eligible contracts as defined under Section 33 of the Act.

Section 3. Secondary Limitation on the Recovery of Costs through the Retail Rates - The limitation on recovery of costs for the generation component in the supply of electricity within the Retail Rate of a Distribution Utility determined pursuant to Section 2, Article IV shall not apply to any amount of electricity in excess of the electricity available under the applicable Regional TSC as demonstrated by the relevant Regional TSC Availability Record. The relevant Regional TSC Availability Record shall be the latest record, as updated, on file with the ERC at the time the Distribution Utility files a rate application with the ERC. In such cases where the Distribution Utility seeks to include generation costs for the supply of electricity in excess of that which is available to the Distribution Utility under the applicable Regional TSC, the ERC shall evaluate the appropriateness of such generation costs with reference to technical, environmental, economic and financial criteria including but not limited to the characteristics of the technologies used to provide capacity and energy under the contract, the diversity of fuel sources, the compliance with existing legislation and government policy, the cost over the term of the arrangements under various scenarios of demand, fuel costs, foreign exchange rates and capital costs, the balance of costs and financial risks incurred, and with reference to the Power Development Plan (PDP) of the DOE. The evaluation methodology shall be applied to all new contracts or amendments to existing contracts. The Distribution Utility shall submit all

relevant technical, economic and financial data as well as cost analyses supporting the contractual costs it seeks to recover through the generation component in its Retail Rates.

ARTICLE V

RECOVERY OF COSTS FOR THE GENERATION COMPONENT OF SUPPLY OF ELECTRICITY SUBSEQUENT TO TERM OF THE TRANSITION SUPPLY CONTRACT

Section 1. Recovery of Costs through the Retail Rates – Subsequent to the expiration of the term of Regional TSCs, the ERC shall evaluate the cost of the generation component proposed to be included in the Retail Rates of the Distribution Utility to its Captive Market based on technical, environmental, economic and financial criteria including but not limited to the characteristics of the technologies used to provide capacity and energy under the contract, the diversity of fuel sources, the compliance with existing legislation and government policy, the cost over the term of the arrangements under various scenarios of demand, fuel costs, foreign exchange rates and capital costs, the balance of costs and financial risks incurred, and with reference to the PDP of the DOE. The evaluation methodology shall be applied to all new contracts or amendments to existing contracts. The Distribution Utility shall submit all relevant technical, economic and financial data as well as cost analyses supporting the contractual costs it seeks to recover through the generation component in its Retail Rates.

Section 2. Cost Recovery Mechanism - Distribution Utilities shall use the Generation Rate Adjustment Mechanism (GRAM) and Incremental Currency Exchange Rate Adjustment (ICERA), if applicable, as approved by ERC to ensure full recovery of prudent and reasonable economic costs associated with purchased power serving the Captive Market regardless of the source of that power.

ARTICLE VI

NEW BILATERAL POWER SUPPLY CONTRACTS

Section 1. New Bilateral Power Supply Contract with an Existing Generation Company – Distribution Utilities may enter into a new bilateral power supply contract with any Generation Company for electricity from any existing generating facility or may make amendments or replacements hereof to an existing power supply contract for the purpose of supplying their Captive Market subject to the limitations of Section 45 of the Act: *Provided*, That prior to the inclusion of any new power supply contract costs in their Retail Rates the Distribution Utility shall file a rate application with the ERC for its approval

of such inclusion of power supply contract costs and the ERC shall have approved such rate filing. Such rate application shall include the following:

- a) A statement indicating whether TSC capacity and energy are expected to be available during the relevant contractual period and all supporting documentation, data and analyses supporting such statement.
- b) All relevant technical and economic characteristics of the generation capacity.
- c) All cost analyses related to the generation in support of the proposed pricing provisions of the contract.
- d) All details on the procurement process used by the Distribution Utility leading to the selection of the Generation Company including request(s) for proposals, proposals received by the Distribution Utility, tender offers, etc.
- e) Details regarding any transmission projects or Grid connection projects necessary to complement the proposed generation capacity including identification of the parties that will develop and/or own such facilities, any costs related to such projects, and specification of the parties responsible for recovery of any costs related to such projects.
- f) Other documents that may be needed by the ERC in the course of the evaluation.

Section 2. Bilateral Power Supply Contracts for New Generation Capacity - Distribution Utilities may enter into a new bilateral power supply contract with any new Generation Company or for the development of new generating capacity for the purpose of supplying their Captive Market subject to the limitations of Section 45 of the Act: *Provided*, That prior to the inclusion of any new power supply contract costs in their Retail Rates the Distribution Utility shall file a rate application with the ERC for its approval, the ERC shall have approved such rate filing and the applicable Certificate of Compliance (“COC”) shall have been issued. The ERC approval process for such rate application shall not exceed six (6) months. Such rate application shall include the following:

- a) A statement specifying all consistencies and inconsistencies between the proposed generation capacity and the DOE’s PDP. Any inconsistencies shall be supported by all relevant analyses including, but not limited to, forecasts and assessment of available generation capacity and technology mix.
- b) A statement indicating whether TSC capacity and energy are expected to be available during the relevant contractual period and all supporting documentation, data and analyses supporting such statement.

- c) All relevant technical and economic characteristics of the proposed generation capacity.
- d) All cost analyses related to the proposed generation in support of the proposed pricing provisions of the contract.
- e) All details on the procurement process used by the Distribution Utility leading to the selection of the Generation Company including request(s) for proposals, proposals received by the Distribution Utility, tender offers, etc.
- f) Details regarding any transmission projects or Grid connection projects necessary to complement the proposed generation capacity including identification of the parties that will develop and/or own such facilities, any costs related to such projects, and specification of the parties responsible for recovery of any costs related to such projects.
- g) Details regarding the load forecast projections in accordance with the latest Distribution Development Plan of the Distribution Utility and the variability of those projections over the term of the proposed contractual period including an estimation of the potential for a reduction in load supplied by the distribution Utility due to retail competition. Any inconsistencies shall be supported by all relevant analyses.
- h) If the application is filed later than two years following the effectivity of these guidelines, the application must include an alternative Demand Side Management (DSM) program that could be implemented by the Distribution Utilities if approved by ERC. The Distribution Utilities shall submit projected costs and benefits of the DSM program.
- i) Other documents that may be needed by the ERC in the course of the evaluation.

Section 3. Bilateral Power Supply Contracts to Serve the Contestable Market –Distribution Utilities and Suppliers may enter into bilateral power supply contracts with any Generation Company for the purpose of supplying the Contestable Market following open access and retail competition subject to the limitations of Section 45 of the Act. Such bilateral power supply contracts are not subject to ERC approval but shall be filed with ERC pursuant to Section 45 of the Act. Any costs related to such contracts entered into by a Distribution Utility to supply the Contestable Market shall be separately accounted for and shall not be recovered in their Retail Rates to their Captive Market.

ARTICLE VII

FINAL PROVISIONS

Section 1. Separability Clause - If for any reason, any part or section of this Guidelines is declared unconstitutional or invalid, the other parts or sections hereof which are not affected thereby shall continue to be in full force and effect.

Section 2. Effectivity – This Guidelines shall take effect on the fifteenth (15th) day following its publication in two (2) newspapers of general circulation.

Pasig City, March 25, 2004.

RODOLFO B. ALBANO, JR.
Chairman

OLIVER B. BUTALID
Commissioner

CARLOS R. ALINDADA
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LETICIA V. IBAY
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