

DRAFT 15 December 2003

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

**GUIDELINES FOR THE RECOVERY OF COSTS FOR THE GENERATION
COMPONENT OF SUPPLY BY DISTRIBUTION UTILITIES**

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 these guidelines:

- a) To establish the process for determining when the recovery of the generation component of the supply of electricity in the retail rates should be limited to the Transition Supply Contract (“TSC”) rate;
- 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

These 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.

- 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 - These Guidelines shall apply to:

- (a) NPC and other Generation Companies providing generation services to Grid-connected load;
- (b) Distribution Utilities;
- (c) Combinations of Distribution Utilities; and
- (d) Direct Connected End Users.

Section 2. Definition of Terms - As used in these 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) **“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;
- (d) **“Direct Connect End User”** shall refer to any person or entity requiring the supply and delivery of electricity for its own use that is directly connected to the Grid;
- (e) **“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;
- (f) **“Energy Regulatory Commission” or “ERC”** shall refer to the regulatory agency created by Section 38 of the Act;
- (g) **“Generation Company”** shall refer to any person or entity authorized by the ERC to operate facilities used in the generation of electricity

(h) **“Grid”** shall refer to the high backbone system of interconnected transmission lines, substations and related facilities, located in each of Luzon, Visayas and Mindanao, or as may otherwise be determined by the ERC in accordance with Section 45 of the Act;

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

(j) **“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:

(k) **“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;

(l) **“Wholesale Electricity Spot Market” or “WESM”** shall refer to the wholesale electricity spot market to be established in accordance with Section 30 of the Act.

ARTICLE III

NPC TRANSITION SUPPLY CONTRACTS

Section 1. Filing and Approval of TSCs - Not later than thirty (30) days following the effectivity of these guidelines, NPC shall file supplementary agreements on TSCs currently filed with ERC, if applicable. For TSCs not yet filed with the ERC, NPC shall file an application with the ERC for approval of pro forma TSCs. The TSCs shall include, at the minimum, regional rate schedules. The ERC shall act on the TSCs within sixty (60) days from the acceptance of the filing. The TSC rate schedules proposed by NPC shall be the same as the rate schedules currently under approval or previously approved by ERC.

Section 2. Record of Available Regional TSCs - Not later than thirty (30) days following the effectivity of these guidelines, NPC and TRANSCO shall jointly file by region the total generation capacity and energy available as certified by the Department of Energy (DOE). Such filing shall include availability by hour under the TSC, the generation capacity and energy taken up by executed TSCs and the generation capacity and energy still available under the TSCs. The filing shall also include all relevant 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. Furthermore, the filing shall include all supporting data, documentation, calculations, and analyses.

Section 3. Offering of TSCs - Subsequent to the approval of the TSCs in the region by the ERC, the same shall be offered to any Distribution Utility or Direct Connect End User in the region subject to availability and in accordance with Section 5, Article III.

Section 4. Initial Request for TSCs by NPC Customers - Not later than thirty (30) days following approval of the TSCs in the region by the ERC, the Office of the President of NPC and the Office of the President of PSALM shall be in receipt of a letter of intent from all new customers of NPC that wish to enter into a TSC. The sender shall simultaneously copy ERC on all letters of intent. A letter of intent shall include the schedule of demand and energy by hour for which the Distribution Utility or Direct Connect End-User intends to contract including as much specificity as possible.

Section 5. Allocation of Available Regional TSCs - Any shortfall by region of total generation capacity and energy available by hour shall be allocated to all TSCs in the region in proportion to each Regional TSCs contribution to total regional demand.

Section 6. Execution of TSCs – Within ninety (90) days of the approval of the TSC in the region NPC shall file with the ERC for its approval a TSC duly negotiated with each Distribution Utility, Direct Connect End User or other party.

Section 7. Filing of an Executed TSC - An executed TSC that follows the approved TSC in the region in its entirety shall have the final approval of the ERC within sixty (60) days following acceptance of the filing. An executed TSC that deviates from the approved TSC shall be subject of an ERC approval process not to exceed ninety (90) days. All deviations between an executed TSC and the approved TSC shall be itemized in the application for approval along with a clear, detailed justification and supporting evidence for each deviation.

ARTICLE IV

RECOVERY OF GENERATION COMPONENT OF SUPPLY COSTS BY A DISTRIBUTION UTILITY FOR THE TERM OF THE TRANSITION SUPPLY CONTRACT

Section 1. Recovery of Costs through the Retail Rates - For the term of the TSC, the comparable regional pro forma TSC rate shall limit the recovery of costs by a Distribution Utility for the generation component of their supply of electricity in their retail rate, Provided, That an equivalent quality and quantity of energy is still available to the Distribution Utility under the applicable regional pro forma TSC as certified by NPC and TRANSCO pursuant to Section 2, Article III. The comparable regional pro forma TSC rate shall computed by projecting forward in time the average regional pro forma TSC

rate 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.

Section 2. Unavailability of TSCs - If TSC generation capacity and energy are not available as certified by NPC and TRANSCO pursuant to Section 2, Article III, ERC shall evaluate the cost of the generation component proposed to be included in the retail rates of the Distribution Utility based on the technical and economic characteristics of the generation source, the technologies used to provide capacity and energy under the contract and strict adherence to the principle of full recovery of prudent and reasonable economic costs. This evaluation methodology shall be applied to all new contracts or amendments to existing contracts. The Distribution Utility shall submit all relevant technical and economic data as well as cost analyses supporting the contractual costs it seek to recover through the generation component in its retail rates.

ARTICLE V

RECOVERY OF GENERATION COMPONENT OF SUPPLY COSTS BY A DISTRIBUTION UTILITY SUBSEQUENT TO TERM OF THE TRANSITION SUPPLY CONTRACT

Section 1. Recovery of Costs through the Retail Rates - ERC shall evaluate the cost of the generation component proposed to be included in the retail rates of the Distribution Utility based on the technical and economic characteristics of the generation source, the technologies used to provide capacity and energy under the contract and strict adherence to the principle of full recovery of prudent and reasonable economic costs. This evaluation methodology shall be applied to all new contracts or amendments to existing contracts. The Distribution Utility shall submit all relevant technical and economic data as well as cost analyses supporting the contractual costs it seek to recover through the generation component in its retail rates.

Section 2. GRAM - Distribution Utilities shall use the Generation Rate Adjustment Mechanism and 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 GENERATION CONTRACTS

Section 1. Effectivity of NPC Generation Tariff - The regulated generation tariffs of NPC shall cease to be effective upon establishment and operation of the WESM. No later than ninety (90) days prior to that date, Distribution

Utilities and Direct Connect End-Users or their agents shall make the necessary arrangements to obtain all power requirements from one or more of the following five sources:

- a. NPC under a Transition Supply Contract (“TSC”);
- b. Generation Company, including NPC successor Generation Companies, under a bilateral contract;
- c. Self-generation;
- d. Distribution Company, only in the case of Direct Connect End-Users; or
- e. the WESM.

Section 2. New Power Supply Contracts – Distribution Utilities may enter into new bilateral power supply contracts with any Generation Company or may make amendments to an existing power supply contract for the purpose of supplying their Captive Market subject to the limitation of Section 45 (b) of the Act: Provided, That the Distribution Utility shall file a rate application with the ERC prior to the inclusion of any new power supply contract costs in their retail rates.

Section 3. Bilateral Power Supply Contracts for Generation Capacity to be Developed - The costs associated with bilateral power supply contracts for serving the Captive Market shall not be included in the retail rates of the Distribution Utility until an application for rate inclusion has been approved by ERC and the applicable Certificate of Compliance (“COC”) has been issued. The Distribution Utility or Utilities, as the case may be, shall file an application for inclusion of the new bilateral power supply contract. The application shall be subject of an ERC approval process not to exceed six (6) months. Such application shall include the following:

- a) A statement specifying all consistencies and inconsistencies between the proposed generation capacity and the Department of Energy’s (“DOE’s”) Power Development Program (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 is 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) Consistent with Section 43(f)(v) of the Act, 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) Any capacity commitments required of the Distribution Utility shall be accompanied by a proposed mechanism for the sharing of risk related to potential lost load due to retail competition.

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 program that could be implemented by the Distribution Utilities if approved by ERC. The Distribution Utilities shall submit projected costs and benefits of the Demand Side Management program.

Furthermore, consistent with Section 43(f)(iv) of the Act, contracts falling under this category shall not include provisions making the Distribution Utility responsible for any costs related to project delays not excused by *force majeure*, penalties and related interest during construction during construction applicable to unexcused delays.

Section 4. Purchased Power Contracts to Serve the Contestable Market – Distribution Utilities and Suppliers may enter into contracts with any Generation Company for the purpose of supplying the contestable market following open access and retail competition. Such contracts are not subject to ERC approval but shall be filed with ERC pursuant to Section 45 of the Act. Any costs related to 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.

ARTICLE VII

FINAL PROVISIONS

Section 1. Separability Clause - If for any reason, any part or section of these 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 - These Guidelines shall take effect on the fifteenth (15th) day following its publication in two (2) newspapers of general circulation.