

Setting Rates for Electricity from Renewable Energy in the Philippines

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Republic Act No. 9136 or the Electric Power Industry Reform Act (EPIRA) ushers in the restructuring of the electric power industry and privatization of government interests in generation and transmission with an end in view of having competition in generation and supply. To oversee all these reforms, the EPIRA vests in a strong and independent regulator, the Energy Regulatory Commission (ERC), sweeping powers not just over the regulated sectors, but also over the wholesale and retail markets, to enable it to implement the reforms sought to be accomplished by the EPIRA.

Among the powers granted to the ERC is the power to set the rates of the one hundred forty (140) distribution utilities (DUs) operating throughout the country. Since the distribution sector is by nature monopolistic, rate regulation, which is founded on the State's police powers, is indispensable. This is to protect the public against arbitrary or excessive rates charged by the distribution utilities (DUs) and to ensure quality of their service to the consumers, in view of the absence of market competition. In setting the rates, however, the ERC is bound by the "just and reasonable" standard in the law.

The ERC regulates a DU's retail rates consisting of its distribution, supply, and metering charges, the proceeds of which go to such DU to answer for its cost of providing service. Included also in the retail rates are the pass-through charges such as for generation, transmission, system loss, lifeline subsidy, and taxes, the imposition of which should result to no loss or gain for the DU.

For its generation or power cost to be recoverable as a pass-through charge, the DU must first secure the ERC's approval by submitting its power supply agreement with the power producer for determination of the recoverable generation cost from such agreement. Without such prior approval, the DU's recovery is capped to its actual cost under such contract or the ERC-approved National Power Corporation (NPC) time-of-use (TOU) rates for the specific grid, whichever is lower. In its review of a power supply agreement submitted to it, the ERC assesses the reasonableness of the stipulated price and other contractual terms affecting the same and based on its evaluation, the ERC may allow full pass through of the costs or limit such recovery to what it deems to be reasonable. For this purpose, the ERC looks at the procurement process undertaken by the DU, employs benchmarks, and defines "reasonable" cost of purchased power using such benchmarks.

On several occasions, the ERC used the NPC-TOU rates as benchmark knowing fully well that the NPC-TOU rates were derived from NPC's costs incurred for supplying power from its various generation plants and from its Independent Power Producers (IPPs) and thus would not entirely be an accurate benchmark to evaluate the reasonableness of the cost of electricity from specific plants. However, it would not only be the ERC that would rely on the NPC-TOU rates as benchmark. Some IPPs and DUs would enter into power supply agreements where the energy would be pegged at such rates or at a few centavos lower than such rates. With such arrangement, they were assured of the ERC's acquiescence to the full-pass through of such costs.

One such contract is the Amended Electricity Sales Agreement (ESA) between Ilocos Norte Electric Cooperative (INEC) and Northwind Power Development Corporation (Northwind) involving a 25 MW Renewable Energy Power System (REPS) in Bangui, Ilocos Norte. According to the project proponent, its decision to undertake the project was in consonance with 10-energy year plan for the Philippines, thus:

The Philippine government has been in the process of restructuring the Philippine power market since serious shortages in the early 1990's. The purpose of the restructuring was to provide reliable power to aid economic growth and development. This led to a trend of power sector investment in the power market and a rash of new projects in the late 1990's based on fossil fuels and hydro. Recently there has been a focus on developing environmentally clean and renewable energy resources. Wind power is recognized as part of the 10-year energy plan for the Philippines and the Department of Energy's (DOE) medium term plan is to increase its wind based power at an average of 40MW per year or up to 415 MW by 2012.

On 6 April 2005, INEC filed with the ERC its application for the approval of its ESA with Northwind. After due notice and hearings, the ERC approved the ESA in toto, thereby paving the way for the start of Northwind's operation of the REPS and the supply of electricity to INEC at the stipulated price of "seven percent (7%) discount on the effective NPC rate per kWh charged to INEC each month, which shall be understood to mean as the cost of electricity to INEC, on a kWh basis, computed by (A) sum of (i) the total generation charge of the NPC and (ii) the total transmission charge of the National Transmission Company (TRANSCO) to INEC; (B) divided by the number of kWh delivered by NPC to INEC in a month, as if NPC is supplying 100% of INEC's requirements and Northwind was not generating any capacity." In explaining its decision, the ERC said:

Finally the Commission finds that the approval of the subject application would mean lower electricity rates to INEC's customers, eradication of INEC's low voltage problem and promoting the utilization of indigenous and renewable energy resources in power generation to reduce dependence of the Philippines on imported energy.

The ERC's approval of the INEC-Northwind ESA was subjected to the condition that, "in the event that NPC rate is no longer applicable due to NPC's privatization and that such no longer provides an appropriate reference rate, the parties are advised to re-negotiate the pricing scheme of the contract which should take into consideration Northwind's just and reasonable cost and file the same for the Commission's approval." The ERC acknowledged that the pricing scheme stipulated in the ESA was not reflective of Northwind's true cost and that the approval thereof was justified primarily by the fact that it still offered a rate lower than the NPC benchmark and that it was a renewable energy project.

There was recognition that had there been no subsidized loan and additional grants from the Danish International Development Agency (DANIDA) for the project,

considering the project cost to be comparatively higher than conventional plants, the pricing scheme could have reflected a higher rate than NPC's. Without also Article 8.1 of the ESA, wherein INEC agreed to take and pay for all electricity that it can consume, with any shortfall to be taken from NPC, during the lifetime of INEC's supply contract with NPC, or from WESM, to mitigate the intermittency of wind generation, the stipulated pricing scheme would not have been feasible. However, all these were tangentially discussed only. In the end, what prevailed was that the ESA offered lower rates for INEC's customers.

Perhaps, it was plain inexperience dealing with this type of renewable energy that the ERC was quick to brush aside these issues and thus failed to take advantage of the opportunity to come out with firm policies regarding the approval of the pass-through rates for electricity from renewable sources. One such issue is the cost of electricity from renewable sources and how its reasonableness can be evaluated using a benchmark. Having one benchmark for all types of project, whether renewable or not, could only place renewable sources at a disadvantage and discourage their development. But then, who should pay the additional cost of renewable energy, including the additional cost for the needed ancillary services? Should it be just the consumers of the DU that contracts with the renewable power provider or all other consumers throughout the country? The ERC would still have to come out with its policies on these and other issues underlying renewable energy, including transmission, subsidies, and reliability issues.

Thus, the challenge for the ERC is this: to craft regulatory policies that would breathe life into the State's policy of promoting "the utilization of new and renewable energy sources in power generation" while ensuring electricity prices that are reasonable, reflective of true cost, and free from cross-subsidization and other distortions.