

12 October 2018

**Hon. Agnes Vicenta S. Torres-Devanadera**  
Chairperson and Chief Executive Officer  
Energy Regulatory Commission  
San Miguel Avenue, Ortigas Center, Pasig City 1600



RE: Position Paper on "Draft No. 2 of the RULES GOVERNING THE PROCUREMENT, EXECUTION, AND EVALUATION OF POWER SUPPLY AGREEMENTS (PSAs) ENTERED INTO BY DISTRIBUTION UTILITIES FOR THE SUPPLY OF ELECTRICITY TO THEIR CAPTIVE MARKET"

Dear Hon. Chairperson:

We note the following objectives that the Rules seek to address:

- (d) To promote transparency in the manner of contracting and accountability among the Distribution Utility (DU) officials-in-charge of contracting power supply, and
- (e) To promote competition among Generation Companies (GenCos) in providing the best offer of power supply which will ensure least cost of electricity for the DUs' captive market in terms of the generation component of their retail rates.

In this regard, we raise the important issue of **automatic fossil-fuel price pass-through** that has been a standard feature of all power supply agreements (PSAs) using coal, gas and oil. Please note that while biomass power plants have the same need for fuel input, no such privilege exists, nor has the BREA sought to have the same for biomass power plants.

The Philippines' current PSA structure, with an automatic fossil-fuel price pass-through model, has the following components: (1) capacity charges (capital recovery, and fixed operating and maintenance charges, both subject to exchange rate and inflation risks in foreign currency); and (2) variable operating and maintenance costs (including fuel). This structure creates two main rate risks:

1. The capital cost is amortized at a fixed rate, over the cooperation period, regardless of whether the assumed capacity utilization or plant load factor is realized.

This practice results in a guaranteed weighted average cost of capital. However, the utilization factor can --- and has been demonstrated to --- fall during the contract period because of lower distribution utility demand, resulting from one of many reasons, including: (a) retail competition, (b) a generalized economic downturn, and/or (c) the

grid's absorption of more variable renewable energy. In any of these cases, effective rates to ratepayers increase. We submit that this practice must be changed.

We submit that the Commission must hold utilities accountable for their own forecasting errors, including generation costs owing to U.S. dollar inflation and exchange-rate volatility, which currently are also passed on to ratepayers without incentives for utilities to insist on more prudent contracting.

2. Among standard PSAs, the Commission only vets the initial fuel costs, even if fuel price movements and volatility risks naturally arise from the fact that thermal fuels are traded in world markets subject to price fluctuations and are also subject to exchange-rate adjustments.

Since the fossil-fuel price risk is passed-through to the consumers, there is no incentive for power generation companies using fossil-fuel to have more prudent procurement and operational efficiencies. For their utility counterparties, such "generation costs" are also treated as "pass-through" and hence the utilities have no incentive to undertake more detailed cost analysis. In the end, it is the electric power consumer who bears all fuel price risk. We submit that this practice must be changed.

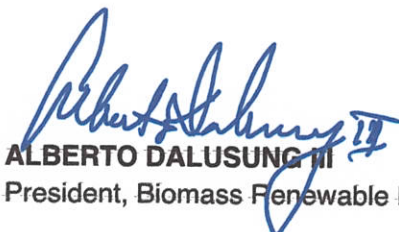
Thus, the current practice of **automatic fossil-fuel price pass-through** is clearly not compatible with the proposed Rules' objectives of transparency and a level playing field for competition to flourish.

**We propose that the Commission replace the current practice of automatic fossil-fuel price pass-through with a requirement for all power plants to declare annual costs of fuel for the duration of the contract period of PSAs.** This is not only fair to ratepayers, but also to renewable energy developers who can offer firm levelized costs.

We are willing to work with the Commission to provide resources and other materials, including case studies in other developing countries like India, on how this has been done.

Thank you for your consideration.

Sincerely,



**ALBERTO DALUSUNG III**  
President, Biomass Renewable Energy Alliance (BREA)