



**RULES GOVERNING THE EXECUTION, REVIEW, AND EVALUATION OF  
 POWER SUPPLY AGREEMENTS ENTERED INTO BY DISTRIBUTION  
 UTILITIES FOR THE SUPPLY OF ELECTRICITY TO THEIR CAPTIVE MARKET**

Document	Article / Section	Discussion of Comment/s and/or Questions for Clarification	Suggestions / Proposed Change(s)
PSA Rules	Article I Objectives  (c) To streamline the review and approval process of PSA	After the completion of the CSP process, ERC is still mandated to review and approve the rates stated in the signed PSA. In this regard, we respectfully suggest that the ERC complete the review process <b>within one hundred eighty (180) days</b> from the filing of the PSA application with the ERC.	
	Article II  Definition of Terms	In the draft rules, we noticed that there is no definition of Physical or a Financial Contract (mentioned in benchmark rate). We suggest that the concept of Physical and Financial supply be included in the definition of terms and the determination of benchmark rate takes into account the difference between such types of PSA	<p><u>(xx) Physical Supply – refers to an arrangement between the DU and the Genco wherein the supply of electricity is identified from a specific plant source and measured through Metered Quantities (MQ) delivered the cost of which will be determined based on the costs associated with the plant or unit (e.g., capacity recovery fee, FOM, VOM, Fuel and other associated costs).</u></p> <p><u>(xy) Financial Supply – refers to an arrangement between a DU and a Generator wherein the supply of electricity need not to be physically matched to the production of a specific plant (e.g., can be sourced from a portfolio of several plants held by the generator or through the WESM). The Generator’s obligation of supplying the DU is satisfied when the Generator declares Bilateral Contract Quantity (BCQ) for the DU.</u></p>

	<p>Article IV Procurement Process</p> <p>Section 2. Competitive Selection Process</p> <p>The entire CSP process should be completed within six (6) months from the publication of the invitation to bid. Failure to complete the process within this period shall invalidate the CSP.</p>	<p>There may be intervening events beyond the reasonable control or foresight of the DU that may prevent it from the timely completion of the CSP in six (6) months (e.g., court restraining orders). We suggest that this provision be dropped as a cause to immediately invalidate the CSP. If a DU has successfully completed a CSP except that it took longer than six (6) months, the DU should still be given the chance to explain why and the merit of such explanation would become part of the decision of the ERC in approving an application. To invalidate a CSP simply because it was not completed in six (6) months would mean further delay in securing supply for a DU as it needs to initiate and complete another CSP.</p>	<p>The entire CSP process should be completed within six (6) months from the publication of the invitation to bid. <u>For this purpose, a certification shall be submitted by the DU as part of the documentary requirement attesting to the completion of the CSP process within six (6) months.</u></p> <p><u>In the event that the CSP is not completed within six (6) months, the DU shall submit an explanation under oath stating the circumstances or reasons why it was not able to comply within the six (6) month period.</u></p> <p><del>Failure to complete the process within this period shall invalidate the CSP.</del></p>
	<p>Section 4. Unsolicited Proposal</p> <p>(a) There is a form of public procurement. When a Distribution Utility receives an unsolicited bid for the supply of electricity, the DU shall then publish and invite third parties to match or exceed it;</p> <p>In the case where the DU receives more than one Unsolicited Proposal, the DU may reject all proposal and instead, bid out the project as a solicited proposal. Otherwise,</p>	<p>We suggest to replace the word “exceed” to “improve.”</p> <p>Using a “first in time” approach as basis of naming an “Original Proponent” would be unfair to another proponent who may have real project to begin with vis-à-vis an opportunit who just had the</p>	<p>a) There is a form of public procurement. When a Distribution Utility receives an unsolicited bid for the supply of electricity, with the DU shall then publish and invite third parties to match or <del>exceed</del> <u>improve</u> it;</p> <p><u>The submission of an Unsolicited Proposal must be complete and not just an offer of MW and price. The proponent, at the minimum, should indicate and provide in the complete proposal the following:</u></p>

	<p>the DU shall evaluate the proposals using a <i>first in time</i> approach. Under this approach, the first complete proposal is evaluated and decided upon. The second proposal will be considered only if the first proposal is rejected or during the “invitation for comparative proposals”</p>	<p>lack of submitting a proposal however incomplete or ill-prepared to pursue a real offer. We suggest that in order to guide the DU in accepting an unsolicited proposal, a minimum documentary requirement and information must be contained in the proposal.</p>	<p><u>* Contract Quantities</u>  <u>* Price</u>  <u>* Contract Duration/Term</u>  <u>* Technology/Fuel</u>  <u>* Governmental Permits already obtained (i.e. ECC, DOE Endorsement, etc.)</u>  <u>* Site Control</u>  <u>* Connectivity</u>  <u>Studies/Agreements (GIS)</u></p> <p>In the case where the DU receives more than one Unsolicited Proposal, the DU may reject all proposal and instead, bid out the project as a solicited proposal. Otherwise, the DU shall evaluate the proposals using a <i>first in time</i> approach. Under this approach, the first complete proposal is evaluated and decided upon. The second proposal will be considered only if the first proposal is rejected or during the “invitation for comparative proposals”</p>
	<p>Section 4.1. Swiss Challenge</p> <p>(a) When an unsolicited proposal is received, the Bids and Awards Committee (BAC) through its Technical Working Group (TWG) shall evaluate within thirty (30) days, the qualification and appropriateness of the proposal. Within this 30-day period, the BAC shall advise the proponent in writing whether it accepts or rejects the proposal. Acceptance means commitment of the DU to submit the proposal for comparative offers by third parties and recognizes the proponent as the “original proponent”</p> <p>(g) When another proponent submits a lower price proposal and the original proponent matches</p>	<p>We propose to rephrase the paragraph for simplicity</p> <p>We understand that once the original proponent matches a lower offer from another proponent, then the original proponent is</p>	<p>a) When an unsolicited proposal is received, the Bids and Awards Committee (BAC) through its Technical Working Group (TWG) shall evaluate within thirty (30) days, the qualification and appropriateness of the proposal. Within this 30-day period, the BAC shall advise the proponent in writing whether it accepts or rejects the proposal <u>and accordingly name it as the “Original Proponent”</u>. Acceptance means commitment of the DU to submit the proposal for comparative offers by third parties. <del>and recognizes the proponent as the “original proponent”</del></p> <p>(g) When another proponent submits a lower price proposal and the Original Proponent matches that price within thirty (30) working days, then the</p>

	<p>that price within thirty (30) working days, then the BAC- TWG will identify which proposal has greater technical merit and submit its recommendation to the BAC for disposition</p>	<p>the winner. Why is there now room for the BAC - TWG to identify which proposal has greater technical merit? All technical merits should be part of the bid components subject to Swiss Challenge.</p>	<p>BAC-TWG <u>shall award the project to the Original Proponent.</u> <del>will identify which proposal has greater technical merit and submit its recommendation to the BAC for disposition</del></p>
	<p>Section 6 Benchmark Rate.</p> <p>The ERC shall establish a benchmark rate that shall serve as reference price that may be used to assess the prudence and reasonableness of the PSA Price.</p> <p>The model will take into account relevant factors such as but not limited to the type of contract (financial or physical), the load factor, load shape and location or reference node to calculate the benchmark price for a portfolio of efficient new entrant plants to match the terms of the PSA being assessed.</p>	<p>If the bids are higher than the established Benchmark Rate (BR), will this result in bid rejection of the proponent? In the event that the all the bids are higher than the BR, will this be considered failed CSP? What if the proponent accepts the bid, will the ERC evaluate the PSA? What if the genco has a bid higher than the BR to take into account the credit risk of an EC will this be justified?</p> <p>We have posed these questions as there are instances that the genco must put a premium in the bid price to take into consideration the creditworthiness of an EC. A triple A EC will have a different default risk compared to an EC with a D rating.</p> <p>It seems that portfolio is a misplaced word. We suggest that the BR should consider the type, the technology involved, the type of operation, the installed capacity, and the location of the generating plant.</p> <p>Also may we ask ERC to consider in the model for determining the BR the following:</p> <p>1) The recovery of efficient cost is premised on a certain cost of capital as</p>	<p>The model will take into account relevant factors such as but not limited to the type of contract (financial or physical), the load factor, load shape and location or reference node to calculate the benchmark price for a <del>portfolio of</del> <u>an</u> efficient new entrant plants to match the terms of the PSA being assessed.</p>

		<p>the discount rate in calculating the LCOE. There must be some underlying level of risks associated with such capital cost – a rate that is commensurate to the credit quality of the payer of the LCOE and the terms and conditions surrounding the sale at LCOE as the price.</p> <p>2) It is worth mentioning that other DU/EC have different credit worthiness, productivity, collection efficiency and system losses, that may be factored in pricing the PSA and may not be captured in the BR.</p>	
	<p>Section 11. Third Party Auctioneer</p> <p>In lieu of the BAC or the Joint BAC, the DU may opt to engage a Third Party Auctioneer (TPA) to conduct and manage its CSP in accordance with these Rules. The TPA shall be subject to accreditation by the ERC.</p> <p>The TPA shall be a team of private individuals or a private corporation duly recognized in the Philippines with experience in competitive bidding and with sufficient knowledge in the electric power industry: Provided that the TPA is not in any way connected to any electric power industry players.</p>	<p>What is the process of ERC accreditation?</p> <p>We suggest to change the team of private individuals to partnership for greater and joint accountability.</p>	<p>The TPA shall be a <del>team private individuals</del> <u>partnership of individual experts</u> or a private corporation duly recognized in the Philippines with experience in competitive bidding and with sufficient knowledge in the electric power industry: Provided that the TPA is not in any way connected to any electric power industry players.</p>
	<p>Article V Requirements and Review Procedures</p>		

	<p>Section 2, Filing of the PSA</p> <p>The application for approval of the PSA shall be accompanied by the following supporting documents:</p> <p>(c) A sworn certification by the DU that a public bidding was conducted;</p> <p>Section 3 Review of the ERC- ERC's evaluation of the PSA and the generation rate will be based on its satisfaction of the following:</p> <p>(a) That the PSA was awarded in accordance with the prescribed procurement process prescribed under Appendix "A" of these Rules, as applicable;</p> <p>(b) That the PSA guarantees suppliers' compliance with the required technical, environmental and financial standards set out in the bid documents; and</p> <p>(c) That the PSA have substantially complied with the PSA Framework under Appendix "B" that accords the parties with equitable rights and that the risk associated with the supply of electricity such as those pertaining to the tariff structure economic indices, foreign exchange fluctuations, volatility of fuel prices and the like are efficiently allocated between parties.</p>	<p>Please include in the sworn certification the period that the CSP process was completed within six (6) months</p> <p>We suggest that the review and approval process of the ERC shall also be time bounded. Final approval decision shall be made within 75 days.</p>	<p>A sworn certification by the DU that a public bidding was conducted <u>and the process was completed within six (6) months</u>;</p> <p>Section 3 Review of the ERC- ERC's evaluation of the PSA and the generation rate will be based on its satisfaction of the following:</p> <p>(a) That the PSA was awarded in accordance with the prescribed procurement process prescribed under Appendix "A" of these Rules, as applicable;</p> <p>(b) That the PSA guarantees suppliers' compliance with the required technical, environmental and financial standards set out in the bid documents; and</p> <p>(c) That the PSA have substantially complied with the PSA Framework under Appendix "B" that accords the parties with equitable rights and that the risk associated with the supply of electricity such as those pertaining to the tariff structure economic indices, foreign exchange fluctuations, volatility of fuel prices and the like are efficiently allocated between parties.</p> <p><u>The ERC review and final approval process shall be done within one hundred eighty (180) days reckoned from PSA filing date.</u></p>
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	<p>Section 4. PSA Pricing Structure.</p> <p>(a) Capital Recovery Fee (CRF) - a capital-related component to recover the cost of investment over the economic life of the plant together rate of return. In the case of an Independent Power Purchase Agreement, the CRF shall pertain to the recovery of fees paid/payable to NPC to operate the plant. This amount shall include a reasonable amount of return on capital based on an ERC approve WACC.</p>	<p>In the previous decisions of the ERC, there has been CRF approval based on Discounted Cash Flow (DCF) and other applications were decided based on annuity methodology.</p> <p>In order for the generator to have clarity in structuring their bids and predictability in the regulatory evaluation process, we suggest that the ERC adopt the DCF methodology.</p> <p>In the DCF, the resulting equity internal rate of return (EIRR) can be compared to the cost of equity using the Capital Asset Pricing Model. ERC can immediately see if the proponent is willing to take a lower tariff if the EIRR is lower than the cost equity form the CAPM.</p> <p>The determination of the CRF using an annuity method is a static calculation which does not factor in changes in the assumptions underlying the calculation during the company's operating life and suffers from the following inherent weaknesses:</p> <p>a) Gearing</p> <p>The gearing used in the calculation of WACC is the capital structure of the company at the start of its operations. Once the company starts principal repayment, the capital structure would change.</p>	<p>(a) Capital Recovery Fee (CRF) - a capital-related component to recover the cost of investment over the economic life of the plant together rate of return. In the case of an Independent Power Purchase Agreement, the CRF shall pertain to the recovery of fees paid/payable to NPC to operate the plant. This amount shall include a reasonable amount of return on capital based on an ERC approve WACC. <u>with cost of capital determined using the Capital Asset Pricing Model (CAPM).</u></p>
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	<p>Section 7 ERC Action on the Application – Any PSA submitted to the ERC shall be reviewed as to its “reasonableness” in terms of costs, risk allocation, and other contractual terms.</p> <p>The ERC’s decision and judgment shall bind both parties and shall not be rendered ineffective or nugatory by any termination or “walk-away” clause incorporated in the PSA.</p>	<p>This results in varying gearing levels and WACC at different periods of the company’s life.</p> <p>b) Income tax rate</p> <p>The ITH secured from the BOI is not considered in the annuity methodology. This benefit is not reflected in the WACC calculation since it assumes a 30% income tax rate during the entire life of the company.</p> <p>What is the objective measure of “reasonableness”. We suggest the ERC to provide the criteria used to evaluate “reasonableness” and the objective criteria therefor</p> <p>We are of the view that the prohibition against the termination or “walk-away” clauses impairs the parties inherent right to freely contract and establish such terms and conditions in the PSA as the parties may deem convenient.</p> <p>The freedom to contract is both a constitutional and statutory right. A contract is a law between two parties and is enforceable as long as it not contrary to law, morals, good customs and against public policy.</p> <p>Termination or “walk-away” clauses are typically incorporated in PSA to provide an opportunity for both parties to withdraw from contractual obligation, where the outcome of external factors have made a particular undertaking different from what the parties have originally intended and agreed upon.</p>	<p><del>The ERC’s decision and judgment shall bind both parties and shall not be rendered ineffective or nugatory by any termination or “walk-away” clause incorporated in the PSA.</del></p>
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