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HON. AGNES VST. DEVANADERA

Chairperson
Office of the Chairman
Energy Regulatory Commission
Pacific Center Building, San Miguel Avenue
Ortigas Center, Pasig City

Comments on the Draft Rules Governing the Procurement, Execution and Evaluation of Power Supply Agreements Entered into by Distribution Utilities for the Supply of Electricity to their Captive Market (ERC Case No. 2018-002 RM)

Dear Chairperson Devanadera,

We are respectfully submitting in the attached matrix our comments, suggestions, and critical issues for the Honorable Commission's consideration in its decision making process regarding the *Draft Rules Governing the Procurement Execution and Evaluation of Power Supply Agreements Entered into by Distribution Utilities for the Supply of Electricity to their Captive Market*.

Please allow us to summarize the key points of our comments and suggestions:

1. **ERC review process for PSA approval should be time bound** – We understand that under Section 43 of the EPIRA, it is the mandate of the ERC to review and approve the retail rates for the captive customers. However, we request that such review must be time-bounded in order for the proponents to avoid costly delays which will ultimately affect the consumers. We suggest that the ERC streamline their review and approval process, taking into consideration that the PSA application has undergone transparent bidding process under the CSP. We respectfully suggest that a Final Approval be given by the Honorable Commission on the PSA application within one hundred eighty (180) days reckoned from the filing of the said PSA. Uncertainty in an unbound approval process raises risks and the basis by which a winning bid is construed (e.g, validity of EPC prices, exchange rates, financing terms) may lapse or may no longer be current and a project may end up stillborn under a prolonged ERC approval process.

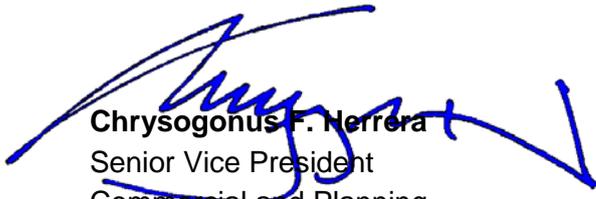
2. **Post Qualification** - We suggest that ERC do away with post qualification to obviate the possible contention, controversy, dispute or allegation of favoritism or rigging when a low as-read bid becomes the subject of a post-disqualification, legitimate or otherwise. We suggest that the CSP be conducted in two discrete and separate stages:
 - a. **First Stage - Prequalification:** The object of this first step is to shortlist only qualified bidders following a detailed examination of eligibility and prequalification requirements such as financial, institutional, technical, marketing and operating capability and experience, proof of working design and technology, and possession of key permits, financing and interconnection to proceed with plant construction and commissioning by target date the contract capacity has to be provided. Short-listed Bidders will be provided full terms and conditions in a Pro-forma PSA which will be the basis of their Price Proposal
 - b. **Second Stage – Price Proposal:** Only the short-listed and prequalified bidders who accepts the Pro-forma PSA will be allowed to submit a “Price Proposal” comprising of the bidders tariff proposal (based on the DU’s prescribed structure), Heat Rate Proposal, Outage Allowance & Heat Rate Degradation Proposal. Ideally, bidders enter proposal using a DU-issued flash drive containing a transparent evaluation algorithm to calculate resulting rate and required bid security.
3. **Benchmark Rate** – We have two concerns:
 - a. We would like to be clarified whether benchmark rate will be adopted by the Honorable Commission as a bid price cap. We note that benchmark rates represent ideal conditions for technology, site and credit risks which may not necessarily match conditions of the CSP. For instance, the buyer’s credit risk may actually be worse than the underlying basis of financing terms the ERC adopted for the benchmark rate; thus, the bid would only be viable at a rate higher than the benchmark. In instances such as this, the bid result should be accepted
 - b. To ensure consistency in the comparative evaluation and analysis bids and the benchmark rate, we suggest that the parameters used in determining the benchmark rate shall also be used as the same parameters in determining the Lowest Calculated Bid. We have provided a calculation methodology for the LCB that the Honorable Commission may consider.
4. **PSA Pricing Structure-** In determining the benchmark rate, we suggest to the Honorable Commission the adoption of the Discounted Cash Flow (DCF) methodology in determining the Capital Recovery Fee (CRF) instead of the Annuity methodology. The Annuity methodology does not reflect very well business reality and dynamism and it is prone to model and parameter errors in that it captures only the opening statements for Assets, Debts and Equity as well as Weighted Cost of Capital. The Annuity methodology assumes away key economic and financial parameters which the DCF methodology additionally captures, e.g., changes in debt level over time (hence, changes in WACC over time) and working capital, minimum cash levels and retentions (e.g., amounts for debt reserve, coverage ratio, dividends based retained earnings cap, minimum operating cash balances), cost of equity during construction, and dividend payout amounts and timing. (We enclose a deck on Setting the Capital Recovery Fee for your consideration.)

5. **Efficient Risk Allocation-** May we know what are the objective parameters that the ERC will use to determine how the foreign exchange fluctuations and fuel price volatility are efficiently allocated between the DU and the Genco. We note that said movement of economic indices are beyond the control of both parties.

6. **Invalidating Termination and “Walk-away” provisions in the PSA** - 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. 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. Without termination or “walk-away” clauses, there can be a situation wherein generators would be forced to supply electricity to the DU at a rate which is not commercially viable and sustainable. This makes the situation inequitable for the generator.

We thank you for the opportunity to provide our inputs to the Draft Rules and likewise express our appreciation to the Honorable Commission’s initiatives to continuously revisit and refine its existing rules and regulations to improve the energy industry.

Respectfully yours,



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Incl: Annex A- Matrix of Comments