

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



**IN THE MATTER OF THE
PETITION FOR ADDITIONAL
COMPENSATION PURSUANT
TO THE ORDER OF THE
COMMISSION IN ERC CASE NO.
2014-021 MC DATED MARCH 3,
2014**

ERC CASE NO. 2014-108 MC

**1590 ENERGY CORPORATION
(1590 EC),**

Petitioner.

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ORDER

On August 27, 2014, 1590 Energy Corporation (1590 EC) filed a petition for additional compensation pursuant to the Commission's Order dated March 3, 2013 issued in ERC Case No. 2014-021 MC.

In the said petition, 1590 EC alleged, among others, the following:

1. On March 14, 2014, it received the Order dated March 3, 2014 issued by the Commission (ERC Order) in ERC Case No. 2014-021 MC [*In the Matter of the Prices in the Wholesale Electricity Spot Market (WESM) for the Supply Months of November and December 2013 and the Exercise by the Commission of its Regulatory Powers to Intervene and Direct the Imposition of Regulated Prices Therein Without Prejudice to the Ongoing Investigation on the Allegation of Anti-Competitive Behavior and Possible Abuse of Market Power Committed by Some WESM Participants*]. The dispositive portion of which provides:

"IN VIEW OF THE FOREGOING, given that prices in WESM during the November and December 2013 supply months could not qualify as reasonable, rational and competitive due to the confluence of factors as pointed out above, and without prejudice to the results of the investigations into the possible culpability of any or all of the market participants, the Commission, in the exercise of the police power delegated to it by the State and for the general welfare of society, hereby VOIDS these Luzon WESM prices and declares the imposition of regulated prices in lieu thereof.

The regulated prices shall be calculated based on the load weighted average of the ex-post nodal trading prices and meter quantity of the same day same trading interval that have not been administered covering the period December 26, 2012 to September 25, 2013, subject to the payment to the oil-based plants of additional compensation to cover their full Fuel and Variable O & M Costs, if warranted, following the manner and procedure for computing additional compensation under the Administered Price Determination Methodology.

xxx

SO ORDERED." (Emphasis supplied.)

2. It is the operator of the Bauang Diesel Power Plant (BDPP). BDPP is a nineteen (19) – year old bunker-fired diesel power plant with twenty-one (21) engines of 10 MW each unit. These twenty-one (21) units are divided into three (3) sectors with seven (7) engines for each sector;
3. With age, the engines have depreciated, with some at the risk of incurring engine block cracks. Thus, even as it has a total installed capacity of 210 MW, it can offer the maximum capacity of only 190 MW. It has consistently reported this available capacity to the System Operator, which can be independently verified by the Commission;

4. It was among the generators who supplied energy to the Wholesale Electricity Spot Market (WESM) during the November and December 2013 supply months, therefore, covered by the ERC Order and can recover additional compensation pursuant thereto;

***Allegations in Support of the
Authority of the Commission***

5. In its Decision dated June 22, 2006 in ERC Case No. 2005-056 RC, entitled "*In the Matter of the Application for the Approval of the Administered Price Determination Methodology for the Philippine Wholesale Electricity Spot Market (WESM)*", in which the Commission evaluated the Administered Price Determination Methodology (APDM) proposed by the Philippine Electricity Market Corporation (PEMC), the Commission explained its authority to approve the said APDM;
6. First, the Commission discussed its authority to approve the APDM. It ruled:

"It may be argued that the EPIRA and its IRR do not explicitly require the approval by the Commission of the APDM and what Section 30 of the EPIRA and Section 10, Rule 9 of the IRR provide is the authority for the Commission to suspend the operation of the WESM or declare a temporary WESM failure "in cases of national and international security emergencies or natural calamities." However, Section 30 of the EPIRA provides that the "price determination methodology contained in said rules [referring to the WESM Rules] shall be subject to the approval of ERC." (Insertion supplied) The said provision simply vests upon the Commission the authority to approve a price determination methodology without making any distinction as to whether the same is applied during a normal operation of the market or during market suspension or intervention. The price determination

methodology that must be applied during normal market conditions is the subject of another application pending with this Commission, and thus the instant application is the methodology referred to by law that should be applied during abnormal market conditions, or in this case, market suspension or intervention.”¹

7. Considering that the ERC Order provides that the manner and procedure for computing additional compensation shall follow the APDM, it invokes the Commission’s authority to approve the instant Petition for Additional Compensation, the basis for which authority was stated in its Decision in ERC Case No. 2005-056;

Allegations in Support of the Claim for Additional Compensation

8. In ERC Case No. 2014-035 RC, entitled “*In the Matter Of The Application For Approval of the Interim Power Supply Agreement (IPSA) Between Manila Electric Company (MERALCO) and 1590 Energy Corp.*”, the Commission had the opportunity to become acquainted with the operational and technical circumstances of BDPP;
9. The following allegations will prove that the calculation of the regulated prices for the months of November and December 2013 by the Commission using the “**load weighted average of the ex-post nodal energy prices and meter quantity of the same day same trading interval that have not been administered covering the period December 26, 2012 to September 25, 2013**” should not be applied to it;
10. At the outset, it must be emphasized that it operates the BDPP as a merchant plant. The approved Interim Power Supply Agreement (IPSA) with Manila Electric Company (MERALCO) was for two (2) months to cover the anticipated peak in summer demand;

¹ Pages 12 and 13 of the Decision in ERC Case No. 2005-056 RC

11. As a merchant plant, in lieu of the **standardized** regulated price in ERC Case No. 2014-021 MC, the manner of treating the fixed and capacity fee in the approved IPSA should be considered.

12. First, the manner by which the Commission evaluated the fixed costs, specifically, Capital Recovery Fee (CRF) and Fixed Operating and Maintenance (O&M) Fee should be considered. The Commission approved a thirty-three percent (33%) capacity factor for 190 MW for 2013 or an average of PhP11.44/kWh, under its IPSA with MERALCO. As a merchant plant, it must be assumed that it would incur the same fee for its CRF and Fixed O&M Fee to be able to recover its revenue requirement for a reasonable return of its investment on an annual basis;
 - 12.1 With regard to the variable costs, the Commission approved PhP0.40/kWh for its Variable O&M Fee and a 0.2438 efficiency factor under the said IPSA. For the instant petition, a 0.26 efficiency factor was used to include the start-up shutdown cost of BDPP. The Fuel Cost is assumed at PhP30.00 per liter;

13. Applying the foregoing, therefore, it should have had a total revenue for twelve (12) months amounting to PhP6,282,266,400.00 or an average of PhP11.44 per kWh at thirty-three percent (33%) capacity factor, had it contracted its capacity;

14. Second, applying the actual energy delivered for the period January to December 2013 using the approved IPSA pricing structure, the total revenue for the twelve (12) - month period should have been PhP3,218,722,242.80 or an average of PhP18.32 per kWh at the actual 10.55% capacity factor;

15. However, instead of PhP6,282,266,400.00 (which could have been due pursuant to the assumptions under the approved IPSA) or PhP3,218,722,242.80 (which could have been due applying the assumptions under the approved IPSA to the actual kWh generated), **it only billed the actual amount of PhP2,593,078,735.11** or an

average of PhP14.76 per kWh. Copies of the actual WESM billing statements are attached to the petition as Annexes "A" to "A-13" and made an integral part thereof;

16. The difference between PhP3,218,722,242.80 and PhP2,593,078,735.11 (the amount it actually billed the WESM) is **PhP625,643,507.69** or PhP3.56/kWh for the its actual sales for the year 2013. **This amount of PhP625,643,507.69 is the additional compensation that it seeks to recover** for its CRF, Fixed and Variable O&M Costs and Fuel Cost.

The calculation showing the foregoing results is attached to the petition as Annex "B" and made an integral part thereof;

17. Considering its load profile on an annual basis, its operation would largely depend on the critical supply of the grid and it would incur losses due to the Must Offer Rule. It mostly derives its revenue/opportunity during peak seasons, such as November and December 2013 and summer months, to augment the scarcity of supply in the grid. Thus, imposing the regulated price upon it on the said period would severely affect the viability and sustainability of its aging plant;
18. In addition, every year, it allocates approximately PhP360 Million of Capital Expenditure in anticipation of major repairs appropriate for an aging plant. Since it only has a three (3) - year contract to operate BDPP, this Capital Expenditure amount, unfortunately, cannot be spread across a longer period of time. Thus, any major repair while under its watch has to be borne exclusively by it. This fact has been recognized and acknowledged during the evaluation of the IPSA by the Commission. BDPP is a nineteen (19) – year old bunker-fired diesel power plant with twenty-one (21) engines, each with a net capacity of 10 MW;
19. The amount of PhP360 Million annual Capital Expenditure is under Fixed O&M Fee. But because ERC Case No. 2014-021 MC voided the market prices for November and December 2013, the said Capital Expenditure has also been cut, unfortunately;

20. The Commission must recognize that as a result of the continuous dispatch for the months of November and December 2013, it has been deferring critical maintenance of its big end bearing housings by limiting the total running hours of the engines. The extraordinary level of dispatch created an unexpected situation in which the maintenance can no longer be deferred but yet the maintenance costs could not be covered by the limited revenue from the said two (2) months. As a result, two (2) crankshaft failures occurred on May 8 and May 10, 2014. A third failure also occurred on June 25, 2014 which indicates that a critical level of running hours has been reached and the risk of further failures is extremely high;

21. Thus, on May 8 and 10, 2014, Engine 23 and Engine 13 suffered crankshaft failures. Based on the July 17, 2014 budgetary proposal submitted by Wartsila, to replace the crankshafts will cost PhP139,104,922.55 for each engine, or a total of PhP278,209,845.10 for both engines, using the Euro-Philippine Peso exchange rate as of July 18, 2014. The cost is exclusive of Value-Added Tax (VAT). A copy of the July 17, 2014 budgetary offer is attached to the petition as Annex "C" and made an integral part thereof.
 - 21.1 In addition, other services will be needed pertaining to the crankshaft failures, which are not covered by the budgetary offer of Wartsila. These services will cost PhP50,723,150.00 per engine or a total of PhP101,446,300.00 for both engines;

 - 21.2 Finally, there is a need to replace three (3) sets of big bearing housings at PhP16,039,568.00 per set or a total of PhP48,118,704.00, using the Euro-Philippine Peso exchange rate as of July 18, 2014; and

 - 21.3 Below is a summary of the costs relating to the crankshaft replacement:

Description	Cost per Unit (PhP)	Qty	Total Amount	Exchange Rate		Offer
Cost of Engines Repair/Replacement						
May 8 and May 10, 2014: Engine-23 and Engine 13 suffered Crankshaft failures						
-Warstsila Budgetary Offer for Crankshaft Replacement (Date of Offer, July 17, 2014)	139,104,922.55	2	278,209,845.10	58.969	Euro	2,358,950.00
- Budget for other jobs not included in the scope of work	50,723,150.00	2	101,446,300.00			
Big Bearing Housing Replacement	16,039,568.00	3	48,118,704.00	58.969	Euro	272,000.00
			427,774,849.10			

22. As the result of the additional risk taken by it in continuously running not as a peaking or ancillary plant as it is supposed to, it is expected to incur **PhP427,774,849.10**. To emphasize, it does not get any return on capital for the said amount;

23. Thus, in accordance with the ERC Order dated March 3, 2014, it seeks to recover the total additional compensation for CRF, Fixed and Variable O&M Fee, Fuel Cost and Engine Cost in the total amount of **One Billion Fifty-Three Million Four Hundred Eighteen Thousand Three Hundred Fifty-Six Pesos and Sixty Centavos (1,053,418,356.69)**; and

24. It prays that:

a. The instant petition be granted and it be allowed to recover the amount of **One Billion Fifty-Three Million Four Hundred Eighteen Thousand Three Hundred Fifty-Six Pesos and Sixty Centavos (1,053,418,356.69)**, through PEMC, broken down as follows:

i. The amount of **PhP625,643,507.69** to be recovered over a period of two (2) billing months - as the additional compensation that it seeks to recover for CRF, Fixed and Variable O&M Costs and Fuel Cost; and

- ii. The amount of **PhP427,774,849.00** to be recovered over the remaining term of the Memorandum of Agreement (MOA) with the Province of La Union which will end on December 2015 - as Additional Compensation for the cost of the replacement and necessary service as a result of the actual damage to Engines 13 and 23 of the BDPP.

Finding the said petition to be sufficient in form and in substance with the required fees having been paid, the same is hereby set for jurisdictional hearing, pre-trial conference and evidentiary hearing on **December 11, 2014 (Thursday) at two o'clock in the afternoon (2:00 P.M.) at the ERC Hearing Room, 15th Floor, Pacific Center Building, San Miguel Avenue, Pasig City.**

1590 EC is hereby directed to cause the publication of the attached Notice of Public Hearing, at its own expense, once (1x) in a newspaper of general circulation in the Philippines, at least ten (10) days before the date of the scheduled initial hearing.

1590 EC is directed to submit, at least five (5) days before the date of initial hearing and pre-trial conference, its Pre-trial Brief containing, among others:

- (a) a summary of admitted facts and proposed stipulation of facts;
- (b) the issues to be tried or resolved;
- (c) the documents or exhibits to be presented, stating the purposes thereof and proposed markings therefore; and
- (d) the number and names of the witnesses, with their written testimonies in affidavit form, if already available, to be attached to the Pre-trial Brief.

Failure of 1590 EC to submit the required Pre-trial Brief and Judicial Affidavits of its witnesses within the prescribed period shall be a ground for cancellation of the scheduled hearing, and the resetting of which shall be six (6) months from said date of cancellation.

SO ORDERED.

Pasig City, November 17, 2014.

FOR AND BY AUTHORITY
OF THE COMMISSION:


ZENAIDA G. CRUZ-DUCUT
Chairperson 4


MVA/NJS

Copy Furnished:

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