

'copy'

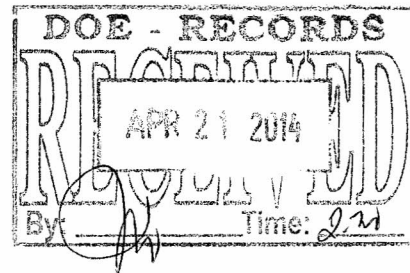
PI PA
PHILIPPINE INDEPENDENT POWER PRODUCERS
ASSOCIATION, INC.

Unit 2408 24th Floor Prestige Tower, F. Ortigas Jr. Road (formerly Emerald Avenue),
Ortigas Center, Pasig City 1605
Telefax: (632) 633-3844

PIPPA 2014-014

7 April 2014

HON. CARLOS JERICO L. PETILLA
Secretary
Department of Energy
Energy Center, Bonifacio Global City
Taguig City, Metro Manila



SUBJECT: Reserve Market Implementation

Dear Sec. Petilla:

We write to express PIPPA's appreciation and support to the Honorable Secretary's commitment to implement the reserve market in the Luzon and Visayas Grids within the first half of the year. We believe that the operation of the reserve market will foster a much reliable grid by allowing the National Grid Corporation of the Philippines (NGCP) to have a bigger market to source the much needed ancillary services. The reserve market will encourage capacity additions from the Generators as their energy market can now be complemented by ancillary market opportunities, hopefully at prices which are reflective of market forces and free from regulatory uncertainties.

While the preparations are on-going for the operations of the reserve market and responsibilities were identified and delineated among the industry stakeholders based on the DOE issued DOE Circular No. 2013-12-0027 on 2 December 2013, please allow us to give our suggestions to improve the reliability of the grid and further enhance the efficient operation of the reserve market.

1. Setting of Reliability Criteria by Stakeholders

We propose that the reliability criteria and levels of operating reserves be set by an independent stakeholders group or an expert panel independent of and distinct from the system operator. This practice has gained wide acceptance in many other countries worldwide. In setting the reliability criteria, the stakeholders group (or the expert panel) shall take into consideration impact of power supply reliability on our economy, the capacity and willingness

of end-users to pay for reliable service, and the practical experience from other regulatory jurisdictions with operational reserve markets.

The reliability criteria and levels of operating reserves are currently set by the ERC based solely on the determination of NGCP as contained in its Ancillary Services Procurement Plan (ASPP). Regrettably, the basis of its reliability criteria is perfunctorily and unsatisfactorily articulated. Moreover, the levels of operating reserves are established using a deterministic method long-eschewed by many other jurisdictions who favor stochastic approach to capture the probabilistic nature of forced outages and the vagaries of demand, maintenance, and hydro generation. Besides, NGCP is conflicted when it takes a direct hand in determining and setting the level of reserves which then becomes part of its own performance indicators under the ERC-approved Performance Incentive Scheme (the ancillary services availability indicator – ASAI). In 2011, a market study¹ by the UP National Engineering Centre suggests using a reliability criterion of 1 day per loss of load expectancy (LOLE) and an operating reserve of about 28% for the Luzon grid. This is higher than the 20% operating reserves target by NGCP. The inadequacy of the current reserve level targets and actual compliance by NGCP are reasons why the Luzon grid suffered 2 near blackout events (on May 8 and July 2, 2013) and which also resulted the highest spot prices in the WESM (in November and December 2013).

For the purpose of setting the reliability criteria and level of operating reserves by stakeholders (or an expert panel), we recommend that the Grid Management Committee (GMC) be charged with this responsibility with the National Transmission Corporation (Transco) providing technical advice. We also suggest that the GMC conducts an open and public process to engage affected end-users in an information, education, and consultation campaign so that cost impacts truly reflect the premium the economy puts on reliability.

2. Guidelines on the Percentage Mix of Ancillary Contracting and Spot Purchases

At the outset of the WESM, contracting transactions were guided by Section 45 (c) of EPIRA, which states that no distribution utility shall source more than 90% of its total demand from bilateral power supply contracts for the first five years from the establishment of the wholesale market. We can surmise that Section 45 (c) was intended to create liquidity in the spot market, even as 90% of requirements is hedged from spot market price volatility. There is merit in adopting a similar construct in the reserve market. We recommend that the DOE issues a guideline circular on the mix of contract and spot purchases for the reserve requirements. We propose that, in the next five years, NGCP should contract ancillary services of not lower than 85% of the system requirement and the remaining 15% to be sourced from co-optimization of energy and reserves trading in the WESM. This arrangement will provide initial liquidity in the reserve market, while avoiding price volatility.

¹ Commissioned by AES, copy enclosed.

3. Unified Cost Allocation and Collection.

Under the proposed Price and Cost Recovery Mechanism (PCRM) application of the PEMC, the reserve market cost shall be allocated 100% to the generators (except for the regulating reserve which is equally shared by the load and generators). On the other hand, under the ERC approved AS-CRM dated October 2007, the ERC ruled that load customers will pay the ancillary costs. If the PCRM application of PEMC would be approved by the ERC, it would result in a bifurcated collection of the costs for ancillary services – the amount collected by NGCP from load customers only and another amount collected by PEMC from WESM market participants (generators and loads). A system of bifurcated collection for ancillary services (reserves costs) not only blurs the pricing signal for the cost of reliability but it also presents conflicting philosophy of cost allocation. Under the AS CRM, the ERC ruled that ancillary services costs be borne by load customers in that it will eventually be paid by the load customers anyway since generators will always pass on these charges to them. Charging it directly to load customers will decrease the number of transactions and correspondingly lessen the operational costs of NGCP and generation customers. On the other hand, the PCRM suggests a different cost allocation based on “causers pay” and thus allocated reserve costs among generators and loads (perhaps in the mistaken belief that, to gain a marketing edge, generators would not fully pass on to customers their related WESM reserve costs).

In view of the foregoing, we believe there is merit in retaining the unified collection system. We propose that the ancillary services costs both under AS CRM and PCRM be collected only from load customers and that NGCP should be charged with this responsibility.

Should you require additional clarification on our proposal we are very much willing to meet with you at your most convenient time.

Thank you for your continued support.

Truly yours,



CHRYSOGONUS F. HERRERA
Vice President – Merchant Generators