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April 25, 2013
PIPPA 2013-011

HON. LUCITA P. REYES – Naty 4/25/13
Officer-in-Charge
Office of the Undersecretary for Industry Development & Trade Policy
3rd Floor, DTI-International Building
375 Sen. Gil J. Puyat Avenue, Makati City 1200

Dear Ms. Reyes,

We write to express our position on the proposal of the Department of Finance (DOF) to limit energy projects which shall be entitled to fiscal and tax incentives for the 2013 IPP to projects that will locate Mindanao. In addition, DOF's rationale in proposing to delist the energy activity in the 2013 IPP is that energy projects can recover their cost of investment through the pricing mechanism without tax incentives. Please allow us to summarize the key points in our support to the retention of nationwide energy activities in the 2013 IPP:

ITH granted to power generators does in fact lower the cost of electricity.

A model was sent to BOI on 27 March 2012, which detailed that removing ITH will have an increase of **Php0.27/kwh** in the generation price differential of a 600 MW new coal plant using the proxy long run marginal cost ("LRMC"). This lower price differential will redound to the consumers in the form of lower generation cost as the ITH will have the effect of lowering the capital recovery fees caused by import duties and income tax grace period.

In the said model, the absolute amount totals to Php1.9 M/MW/yr. Based on the latest DOE projection, Luzon Grid needs an additional 8,500 MW by 2030 and without ITH, this will translate to a Php16.5 billion aggregate cost charged to consumers. Please see attached Annex A.

Additionally, the ITH will contribute to: i) get and secure better and eventually financing for new projects in Luzon; ii) attract quality investors to the country considering the increasing competition for investment in the region; iii) positively contribute to keep the electric industry well supplied for the Public Private Partnership Projects which would require proper infrastructure.

We also note that DOF is keen on retaining the incentives for energy projects that will locate in Mindanao. We believe that locational preference of giving incentives, i.e. Mindanao power projects, will only shift the problem of attracting investors for capacity addition and provide specific area bias.

A lower generation cost due to granting of fiscal and tax incentives in fact supports the DOF's position to develop the export-oriented investments, micro and small enterprises and research and development activities by making them competitive in terms of lower input cost, i.e. generation cost.

As base load power plants are capital-intensive to develop, the incentives are necessary to keep capital costs low and early cash flows robust, ensuring that investments thereon are sustainable in the long run and power rates are competitive. The delisting of energy projects in Luzon and Visayas sends the wrong signal by directly burdening the targeted export oriented industries – it would remove incentives to be granted to key infrastructure projects that are critical in keeping the operating costs of export-oriented industries competitive and sustaining their production in the long run.

We hope that this data will help the Board of Investments and the Department of Finance reconsider its position and restore the ITH in full to the energy sector and to the consumer it serves.

We will be happy to discuss with you any question or comment you may have on the foregoing.

Thank you.

Sincerely,

ERNESTO B. PANTANGCO
President

Cc: Undersecretary Adrian Cristobal, Jr.
Department of Trade & Industry

Secretary Carlos Jericho L. Petilla
Department of Energy

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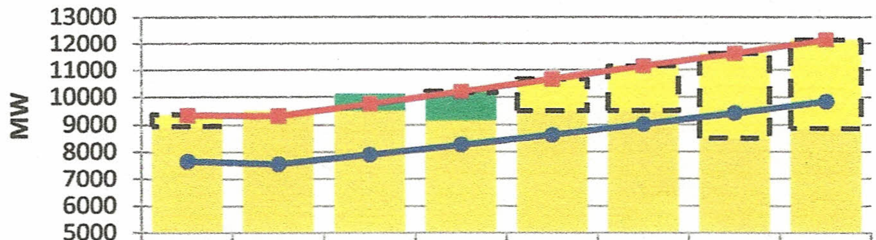
ANNEX A

The Philippine Power Industry will need additional generating capacities in order to meet it's growing demand requirements. This is becoming more evident with the economy's continously improving performance that is expected to translate to higher power demand forecasts.

The Luzon Grid is already experiencing reserve deficiency as early as 2013. With peak demand growing at an average of 4.5%, even with the entry of 110 MW from Bac-man Geothermal and 300 MW from GN Power in 2013, 40 MW to 1152MW of additional capacity is still necessary to fulfill the ~23% reserve requirement from 2013 to 2014, with no more major power plants expected to come on line by that time. Furthermore, the Luzon Grid is in need of and additional 3,280 MW spread throughout 2014 to 2017 maintain the reserve requirement throughout the year.

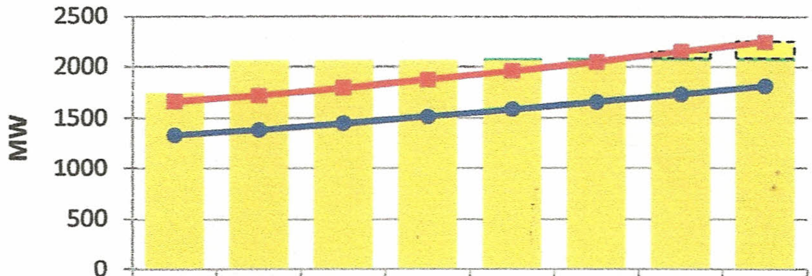
Luzon Supply-Demand Forecast (2011-2017)



	2010 - Actual	2011 - Actual	2012	2013	2014	2015	2016	2017
Reqd Additional Capacity	416	0	0	40	1152	1637	3120	3280
Committed Capacity	0	0	600	1010				
Existing Dep Capacity	8941	9504	9504	9141	9504	9504	8491	8854
Reqd Reserve Margin	1701	1774	1865	1944	2038	2135	2200	2299
Peak Demand	7656	7552	7892	8247	8618	9006	9411	9835

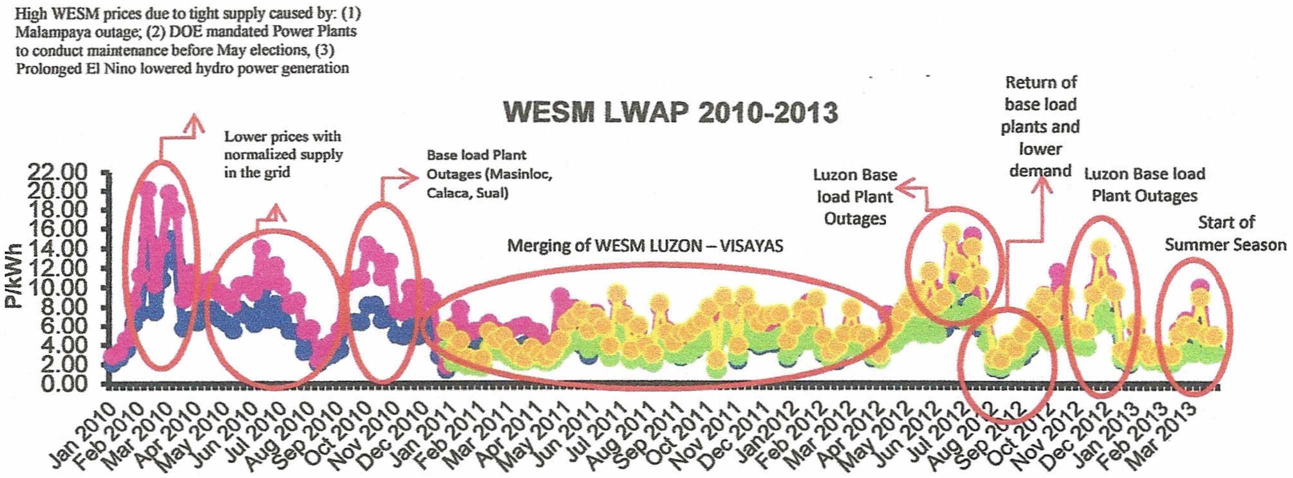
With little capacity coming online in the next few years, supply will tighten and will eventually be insufficient, starting in 2016.

Visayas Supply-Demand Forecast (2011-2017)



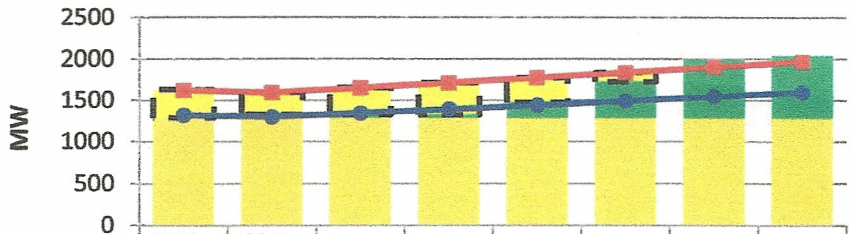
	2010 - Actual	2011 - Actual	2012	2013	2014	2015	2016	2017
Required Additional Capacity	0	0	0	0	0	0	69	168
Committed Capacity					20	25	25	25
Existing Capacity	1745	2057	2057	2057	2057	2057	2057	2057
Required Reserve Margin	335	339	348	361	375	390	418	437
Peak Demand	1333	1384	1448	1514	1584	1657	1733	1813

The tight supply conditions in the Luzon and Visayas grids are reflected in the WESM average spot prices. This is readily observed in the shooting up of prices whenever plant outages occur in the grid which is largely due to the lack of sufficient reserve levels. Thus, the WESM efficiently provided the proper price signals to reflect the dynamics of supply and demand in the Luzon and Visayas grids



In the Mindanao Grid, 2013 supply is actually insufficient to cover both the reserve and peak demand requirements. This is attributable to heavy dependence on unreliable hydro capacity which is worsened by the El Nino phenomenon in 2013. Reserve requirements will only be fulfilled once new coal capacities come in by 2016.

Mindanao Supply-Demand Forecast (2011-2017)



	2010 - Actual	2011 - Actual	2012	2013	2014	2015	2016	2017
Required Additional Capacity	342	273	329	388	299	112	0	0
Committed Capacity	0	42	42	42	192	442	705	755
Existing Capacity	1282	1282	1282	1282	1282	1282	1282	1282
Required Reserve Margin	304	299	309	320	332	343	356	368
Peak Demand	1320	1298	1344	1392	1442	1493	1546	1601

In sum, the statistics point to the fact that there is an actual and existing need for new capacity across all three grids in the Philippines. Thus, any form of aid or incentive to attract investors to put-up the much necessary capacity shall be of much value in view of ensuring sufficient power supply for the continuously growing power demand.