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PIPPA

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ENERGY REGULATORY COMMISSION
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ENERGY REGULATORY COMMISSION
Pacific Center Building
San Miguel Avenue
Ortigas Center 1600, Pasig City
Metro Manila
Philippines

Attention: **Hon. Zenaida G. Cruz-Ducut**
Chairperson

Re: **Proposals for Amendments to the Rules in Setting Transmission and Wheeling Rates**

Dear Hon. Chairperson Ducut,

The Philippine Independent Power Producers Association ("PIPPA") wishes to present several matters that should be included in the *Issues Paper* pertaining to the Rules in Setting Transmission Wheeling Rates. This is in line with the upcoming regulatory reset for the National Grid Corporation of the Philippines (NGCP) for 2016 -2020.

The Philippine Grid Code (PGC) states that the "Grid Owner" is responsible for providing and maintaining all Grid Equipment and facilities, including those required for maintaining Power Quality (PGC, 7.3.2.1). "Generators", on the other hand, are simply tasked to provide accurate and timely planning and operations data to the "Grid Owner" and "System Operator" (PGC, 7.3.3.2). However, generators who are expanding or building new plants often find themselves in the situations where they have to shell out their own funds to pay for transmission infrastructure necessary to carry the capacity of their new units. Such a situation arises whenever a generator's expansion was not considered in the drafting of the Transmission Development Plan, and ultimately, in the setting of the annual revenues of the National Grid Corporation of the Philippines (NGCP). The problem is compounded with the fact that the existing policies (or unregulated practice) do not provide procedures for the timely and full recovery of the costs shouldered by the generators, and there are no fixed technical parameters or guidelines for the construction of the additional infrastructure.

I. Background

The development and construction of generation facilities requires the execution of key activities, not only by the generation company, but also by key actors outside its influence. This includes securing the necessary governmental permits, most important of which is the

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Environmental Compliance Certificate (ECC) from the DENR, financing from lending institutions, engineering, design and construction of the generation facility, and interconnection with NGCP's transmission system. These key activities will require between 3 – 5 years to complete (or more for hydro and nuclear) and, thus, will require the concerted efforts of the key actors to ensure that the generation facility satisfies its intended purpose of supplying the demand of its off-taker/s on the target year.

Transmission interconnection is a critical activity since it is key to both financing and the eventual testing, commissioning and commercial operation of the generation facility. It in itself is a major and critical project which will require NGCP and to secure regulatory permits and approvals (e.g., Grid Impact Study, Facility Study, Connection Agreement, ERC authorization, ECC, etc.), right-of-way acquisition, design, engineering and construction. The successful and on-time completion and commercial operation of the generation facility requires that the transmission interconnection be available prior to the testing and commission stage. Failure to do so will result to a number of consequences (e.g., failure to supply demand, contractual obligations with the equipment supplier, etc.). Thus, the generation company is motivated to advance the construction of the transmission interconnection.

II. Issues

In view of the aforementioned, PIPPA would like to highlight following concerns:

1. *The current Rules for Setting Transmission Wheeling Rates (RTWR) do not have sufficient provisions for the upgrade of the transmission network in support of the capacity additions*

   The computation of the Annual Revenue Requirement (RTWR, 4.4.1) for each regulatory year in a regulatory period takes into account the forecasted capital expenditure of NGCP (RTWR, 4.7.2) (RTWR, 4.10). The RTWR, as a general rule, requires separate identification and categorization of each capital expenditure project which is forecasted to cost PhP 50 million or more (RTWR, 4.10.1).

   Although the RTWR does not explicitly assign a special fund for (unforecasted) capital expenditures on transmission interconnections of generation facilities apart from those identified in NGCP's Regulatory Reset application, the RTWR actually allows for forecasted capital expenditures which are not allocated to individually identified projects, so long as it is accompanied with a justification of its necessity and reasonability (RTWR 4.10.3).

   Despite this, generators that wish to enter but were not included in the forecasted capital expenditures for a regulatory period, usually end up paying for the cost of putting up the transmission upgrade infrastructure to accommodate the new capacity following NGCP's design and specification, which might be more that the required specifications as per the PGC.

   If an allocation for transmission upgrades is in place but is overdrawn due to the actual number of new generation capacity being built, it is not unreasonable to ask any additional projects to finance the upgrade of transmission facilities associated with the generator's

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project. However, the recovery period and interest rate should be established by the policy of the regulator. It is the current (unregulated) practice for the generator to be required by NGCP to finance and/or construct its own transmission infrastructure. However, no existing policy provides a guide on how the generator may recover said costs.

The generator is usually asked to wait for the end of the subsisting regulatory period to be included in the next regulatory reset process before it would be able to start recovering its expenditure on the transmission infrastructure. The regulatory reset process starts 21 months prior to the end of the end of each regulatory period (RTWR, 7.1). A regulatory period usually lasts for five (5) calendar years (RTWR, 2.5.1).

There is also no regulation on the period of recovery. Often the generator is paid over a four or five-year period, so his recovery of costs can range from five to eight years, depending on the timing of its expenditure and the start of the next regulatory reset process. Moreover, the valuation methodology of the transmission assets - Optimized Depreciated Replacement Cost (ODRC) – presents a risk on whether the full cost shouldered by the generation companies can be recovered through the transmission charges. If, say, a transmission reinforcement shouldered by a generating company was commissioned four years before the start of the succeeding (five-year) regulatory period, its ODRC would be reckoned at the start of that regulatory period. The RTWR currently does not clarify how the depreciation for the four years prior to the succeeding regulatory period would be considered in the valuation of the asset and, hence, ensure the recovery of the expenses associated to it that were shouldered by the generators.

Neither does a policy exist for the treatment of VATable charges. This must be specially addressed given that NGCP is not subject to VAT while generators putting up the transmission assets are not VAT exempt.

Furthermore, the repayments are without interest, so the generator suffers losses from the loans taken out to finance the transmission line upgrades – or in the case of equity spending, opportunity costs for the capital are not accounted for. There should be a policy for the indemnification of generators for interest or opportunity cost losses resulting from the delayed recovery period.

2. *The PGC and the 2006 OATS Rules do not provide for guidelines on building of transmission assets by generators*

There are no hard and fast rules on the procedures that will be undertaken whenever generators are required to construct transmission facilities at their own expense. Generators are constrained to follow designs and specifications prescribed by the NGCP which could be above the minimum requirements set by the PGC. The generator bears the risk of not being able to recover the cost of any transmission asset that is "optimized down" by the regulator.

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Furthermore, generators are left without support and jurisdiction on matters such as obtaining a Right-of-Way (ROW). The power of eminent domain was only extended by the State to the Transmission and Distribution sectors, and has not been granted to generators (EPIRA Sec. 8, Sec. 23). This provides a physical and legal restriction on the construction of transmission infrastructure by generators. Another risk is that the negotiated lease price or purchase price might not be accepted by NGCP or the Honorable Commission. Thus, the generator will not recover its full costs.

III. Recommendations

To address the enumerated issues, PIPPA presents the following recommendations:

1. *Sufficient NGCP Contingency Fund to represent funds for the construction of transmission assets for new generating units*

   We understand that the ERC is currently reviewing its regulatory methodology and process. We respectfully suggest the inclusion of a mechanism that will provide NGCP with an allocation for transmission upgrades for yet identified new capacity in the modifications to the Rules in Setting Transmission Wheeling Rates. It is PIPPA's view that, as a general rule, NGCP should finance, construct, own and operate all transmission asset facilities. NGCP may conduct a Monte Carlo Simulation to arrive at the most efficient amount necessary to be maintained in the contingency fund. The simulation would consider sensitivities on the needed transmission upgrades based on possible deviations from the commissioning date of generators (especially those that may cross-over between regulatory periods). Incorporating probabilities based on NGCP's judgment (and verified by an Independent Expert during the Reset Process), an estimated value of the contingency fund can be arrived at. Also, the methodology on the disbursement of such "contingency fund" must be also be strengthened by the ERC.

   In order to minimize NGCP's risk in the maintenance and disbursement of this fund, availing generators may be required to post a performance bond, possibly equivalent to the permit fees (0.75% of the total project cost, the minimum amount required for NGCP by the ERC for unforecasted capital expenditures (e.g., Decision on ERC Case No. 2010-009 RC). In turn, the Energy Regulatory Commission (ERC) must compel NGCP to put up the necessary transmission infrastructure upon the generator's posting of the performance bond. Furthermore, a method to "claw-back" or transfer unutilized funds to the next regulatory period may also be set to ensure fair and efficient allocation. This is currently enshrined in the Net Efficiency Adjustments (RTWR Article IX) but is evaluated on a per project basis for those specifically identified by NGCP. Additional nuances must be established for unforecasted capital expenditures.

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2. *NGCP Policy and Methodology for the Recovery of Generator's Transmission Asset Costs*

If the generator constructs the transmission asset due to lack of funds of NGCP, then the asset should only comply with the minimum standards as per the PGC. If NGCP requires more than the minimum standards, then NGCP should already finance such an upgrade.

PIPPA believes that it is imperative that policies and methodologies should be established for the recovery of a generator's transmission asset costs. The total actual costs of the transmission asset should be recovered in full by the generator. Moreover, such policies must take into account the VAT-related issues. For instance, please note that NGCP is only liable to pay the 3% franchise tax in lieu of all other taxes, while the generator is liable for other taxes such as VAT. Lastly, the policy must specify a recovery period for the generator's costs with the applicable interest charges equivalent to NGCP's approved Weighted Average Cost of Capital (WACC).

3. *RTWR Methodologies patterned after the DSOAR Model*

PIPPA proposes to address the lack of guidelines and methodologies by emulating the Distribution Sector, through the Amended Distribution Services and Open Access Rules (DSOAR) model:

i. Transmission line extensions should be designed to connect with the nearest existing transmission facility.
ii. NGCP transmission upgrade requirements should be compliant with minimum facilities prescribed by ERC-approved standards, PGC and National Building Code, etc.
iii. If NGCP designs the line extension along an alternative route or design standard that serves the interest of the NGCP, all additional costs attributed to the modification should be at the cost of NGCP. NGCP shall obtain ROW for the alternative route.
iv. In the event that the generator cannot obtain ROW for the connection asset, NGCP may, by power of eminent domain, obtain ROW at the sole expense of the generator.

The DSOAR is well-equipped with a policy governing requests of end-users for the extension of lines or installation of additional facilities with their Distribution Utilities (DU). The transmission sector should have a similar policy.

In the DSOAR, minimum facility requirements for the engineering and design of the line extensions were set by the ERC-approved standards (DSOAR, 2.6.4 and 2.6.5). Costs for end-user requests beyond standard connection facilities and, in turn, costs for DU requests in excess of what is necessary to serve the end-user, shall be for the account of the respective parties (DSOAR 2.7) The DSOAR even provides for cost-sharing for multiple end-users of the line extension to ensure a proportionate distribution of the charges (DSOAR 2.7.10). Such

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guidelines and parameters can be adapted to suit the relationship between generators and the NGCP.

We hope for your kind consideration in addressing and including our concerns in the Issues Paper for the Rules in Setting Transmission Wheeling Rates. Further, we would like to respectfully request for a discussion with the Honorable Commission regarding the above proposal.

Sincerely,

Philippine Independent Power Producers Association

Luis Miguel O. Aboitiz
President and Board Member