

Republic of the Philippines  
DEPARTMENT OF ENERGY

DEPARTMENT CIRCULAR NO. DC 2004-01-001 *cs*

**PRESCRIBING THE RULES AND PROCEDURES FOR  
PRIVATE SECTOR PARTICIPATION IN EXISTING  
NPC-SPUG AREAS PURSUANT TO RULE 13 OF THE  
IMPLEMENTING RULES AND REGULATIONS OF THE  
ELECTRIC POWER INDUSTRY REFORM ACT OF 2001  
(EPIRA-IRR)**

**WHEREAS**, it is the declared policy of the State to ensure and accelerate the total electrification of the country;

**WHEREAS**, under Section 1 of Rule 13 of the EPIRA IRR, the Department of Energy (DOE) is tasked to issue specific guidelines on how to encourage the inflow of private capital and the manner whereby other parties including distribution utilities and qualified third parties can participate in the missionary electrification;

**WHEREAS**, under Section 3 of the EPIRA IRR, the Small Power Utilities Group of the National Power Corporation (NPC-SPUG), is mandated to periodically assess the requirements and prospects of bringing power generation and associated power delivery systems to commercial viability on an area-by-area basis including a program to encourage private sector participation;

**WHEREAS**, missionary electrification functions of NPC-SPUG are funded from the revenues from sales in missionary areas and from the Universal Charge, the participation of private sector shall reduce the burden on the missionary electrification component on the Universal Charge (UC-ME);

**WHEREAS**, the participation of private sector in missionary areas shall reduce the burden on the UC-ME;

*MP*

**NOW, THEREFORE, FOR AND IN CONSIDERATION OF THE FOREGOING PREMISES,** the DOE hereby issues the following guidelines and procedures to guide and encourage the private sector to participate in existing NPC-SPUG areas:

**Section 1. Definition of Terms.**

Unless the context otherwise indicates, the terms used in this Circular shall have the following meanings:

- (a) "**Act**" refers to Republic Act No. 9136, otherwise known as the "Electric Power Industry Reform Act of 2001;"
- (b) "**Best New Entrant Tariff**" refers to the tariff which would need to be charged by an efficient entrant to cover its costs and earn a reasonable return on capital;
- (c) "**Commercially Viable**" refers to an area or service where the resultant True Cost Generation Rate is equal to or less than the Socially Acceptable Generation Rate;
- (d) "**Conclusion Program**" refers to the program prescribing the period/duration that the UC-ME will be made available to the New Private Provider (or "NPP") from the effectivity date of the take over of an NPC-SPUG area;
- (e) "**Floor Price**" refers to the price at which NPC-SPUG specifies it is willing to sell an asset to an NPP selected to serve an NPC-SPUG area. The Floor Price may be set at a fair value, as appraised by an independent appraiser, or to the book value of the asset;
- (f) "**Graduate**" refers to any area where provision of Missionary Electrification Subsidy is remove/stopped, by reason that the area or service is deemed Commercially Viable;
- (g) "**IRR**" refers to the implementing rules and regulations of Republic Act No. 9136, otherwise known as the "Electric Power Industry Reform Act of 2001;" *VSP*

- (h) "**Missionary Electrification**" refers to the provision of basic electricity service in Unviable Areas with the ultimate aim of bringing the operations in these areas to viability levels;
- (i) "**Missionary Electrification Subsidy**" refers to the subsidy approved by ERC to be paid to an NPP to allow it to recover its True Cost Generation Rate while charging the Distribution Utility the Socially Acceptable Generation Rate. The Missionary Electrification Subsidy shall be funded from the UC-ME based on the petition filed by NPC-SPUG;
- (j) "**New Missionary Areas**" refers to an area declared Unviable by the Distribution Utility for any reason and offered to private sector for supply of electricity;
- (k) "**New Private Provider**" or "**NPP**" refers to an entity deemed technically and financially capable to serve/take over existing NPC-SPUG areas, resulting from the competitive bidding exercise;
- (l) "**NPC-SPUG**" refers to the functional unit of NPC created to pursue the Missionary Electrification function;
- (m) "**NPC-SPUG Area**" refers to a geographic area currently supplied with electricity generated by NPC-SPUG;
- (n) "**Power Supply Agreement**" or "**PSA**" refers to an Agreement between a power producer and a Distribution Utility for supply of power;
- (o) "**Socially Acceptable Generation Rate**" refers to the rate, which ERC has determined would be desirable, on social acceptability grounds, for a Distribution Utility to pay for power to supply a current or former NPC-SPUG area. The Socially Acceptable Generation Rate combined with the Missionary Electrification Subsidy should equal the True Cost Generation Rate; *VP*

- (p) "**Transaction Advisor**" refers to a professional/expert engaged by DOE to assist in developing the most appropriate privatization program for existing NPC-SPUG areas;
- (q) "**True Cost Generation Rate**" refers to the full efficient costs of generating power in an area. For the purpose of this Circular, True Cost Generation Rates shall be determined on the same basis provided for under Section 43(f) of the Act for setting or determining transmission wheeling rates and retail rates for the captive market of a Distribution Utility to allow sufficient recovery of just and reasonable costs and a reasonable return on rate base (RORB) to enable the entity to operate viably; and
- (r) "**Unviable Area**" refers to a geographical area within the Franchise Area of a Distribution Utility where immediate extension of distribution line is not feasible;

*Other words and phrases have the same meanings as in EPIRA and its IRRs.*

## **Section 2. Declaration of Policies for Missionary Electrification.**

- (a) This Circular shall only apply to all areas being served by NPC-SPUG.
- (b) All existing NPC-SPUG areas are hereby declared open for private sector participation. For the purpose of this Circular, private sector participation shall mean "the take over of the supply of electricity to any existing NPC-SPUG areas, either through outright purchase or lease of existing NPC-SPUG assets, and/or installation of new power generating facilities including associated power delivery systems."
- (c) NPC-SPUG shall endeavor to privatize its power generation facilities and associated power delivery systems.
- (d) When NPC-SPUG ceases to serve an area, it may sell its assets in the area or redeploy to serve another area. The sale of assets vsp

of NPC-SPUG shall follow the government's standard accounting procedures.

- (e) Distribution utilities currently sourcing power supply from NPC-SPUG, wholly or partly, are encouraged to seek NPPs. The NPPs shall be selected based on competitive bidding with the view to minimize power purchase cost of the Distribution Utility.
- (f) In cases where a Distribution Utility does not select an NPP, NPC-SPUG will assign its existing Power Supply Agreement (PSA) to a competitively selected NPP, if this would lead to a reduction in the total cost of power supply.
- (g) DOE shall promote policies that will strengthen governance structure such as protection of investors' rights and consumer education in NPC-SPUG areas that were taken over by NPPs.
- (h) The DOE shall prescribe the Conclusion Program in existing NPC-SPUG areas taken over by NPPs to optimize the utilization of the UC-ME.

### **Section 3. Procedures for Selection of New Power Providers.**

- (a) A competitive process shall be used to select one or more NPPs to supply power to each NPC-SPUG area.
- (b) The competitive process shall be designed to ensure that prospective NPPs intending to participate in NPC-SPUG privatization program possess suitable level of financial and technical capacity. The process design shall give due consideration to achieving the lowest long-term cost of power and services, environmental compatibility with the local area, and the most advantageous implementation schedule.
- (c) Distribution Utilities operating in existing NPC-SPUG areas shall have the following options in managing the competitive process for the selection of their respective NPPs: *VP*

- (i) Request DOE to secure a Transaction Advisor or engage the services of a Transaction Advisor, at its own cost, to assist in selecting the appropriate NPP;
  - (ii) Allow NPC-SPUG to assign its existing PSA to an NPP through a competitive process; or
  - (iii) Manage the competitive selection process by itself.
- (d) To ensure an orderly and well managed process, Distribution Utilities operating in NPC-SPUG areas shall be grouped into 'waves,' based on the suitability of the area for supply by an NPP:
- (i) The first wave shall include areas deemed most attractive for NPPs, or which are causing the greatest losses to NPC-SPUG;
  - (ii) DOE shall notify the Distribution Utilities in a wave that they are to choose one of the three options to select their NPP/s. After being so notified by DOE, a Distribution Utility must within two (2) months, notify DOE and NPC-SPUG, which option it has selected. If the Distribution Utility does not notify DOE or NPC-SPUG within the prescribed time period, it shall be deemed to have selected option under Section 3(c)(ii).
  - (iii) Any Distribution Utility, which wishes to be included in the first 'wave' may notify DOE, and shall be so included.
  - (iv) Distribution Utilities, which selected option under Section 3(c)(iii), shall be monitored by DOE to ensure that their progress toward selection of an NPP is comparable to that of the Distribution Utilities, which opted to use option under Section 3(c)(i) or option under Section 3(c)(ii). If a Distribution Utility falls significantly behind schedule compared to Distribution Utilities under the other two options, DOE may offer that Distribution Utility the option to adopt Section 3(c)(i), or may assign it to option under Section 3(c)(ii) (i.e., NPC-SPUG shall select the NPP and

assign its PSA, thus removing the Distribution Utility's control of the process).

- (e) Once an NPP has been selected, NPC-SPUG shall accordingly assign, amend or terminate its PSA with the concerned Distribution Utility in such a way as to provide a smooth and efficient transition to the NPP.
- (f) Towards this end, NPC-SPUG shall, within one (1) month from effectivity of this Circular, prepare and submit to DOE its proposed groupings or waves, consistent with subparagraph (d) of this section.

#### **Section 4. Disposal of Surplus NPC-SPUG Assets.**

- (a) NPC-SPUG shall dispose of its surplus assets once an NPP is in place and NPC-SPUG phases out supply and services to the area.
- (b) Disposal of Generation-related assets.

All generation assets and other NPC-SPUG assets, which were used to serve an area, with the exception of subtransmission assets, will be disposed of through the following process:

- (i) NPC-SPUG shall offer the winning NPP the right to buy the assets at a Floor Price. The option to purchase, together with the Floor Price, shall be provided in the PSA bidding documents.
- (ii) The Floor Price shall be set by an independent appraiser, based on the value of the asset to NPC-SPUG in other uses or its sound value, or may be set at the book value of the asset.
- (iii) In the event that the winning NPP does not exercise its option to purchase the assets at the set floor price, NPC-SPUG may redeploy the asset to serve another NPC-SPUG area, or otherwise shall, within two (2) months, auction the assets through an open, ascending bidding process.

The winning NPP shall have the right to participate in this auction.

(c) Disposal of Subtransmission Assets.

NPC-SPUG shall dispose of its subtransmission assets according to the following process:

- (i) NPC-SPUG shall first offer the subtransmission assets to the relevant Distribution Utility they serve, using the same procedure as that set out for sale of National Transmission Company (TRANSCO) subtransmission assets to Distribution Utilities prescribed in Section 8 of EPIRA, Rule 6 of EPIRA IRR and guidelines issued by the Energy Regulatory Commission (ERC) on 17 October 2003 on the sale and transfer of the TRANSCO subtransmission assets and franchising of qualified consortia. This includes determining the disposal value of the assets on the basis of its revenue potential.
- (ii) If the Distribution Utility does not agree to buy the subtransmission assets, NPC-SPUG shall offer the sale to any consortium of Distribution Utilities or to TRANSCO at the same price.
- (iii) If no buyer for the assets can be found, NPC-SPUG shall endeavor to enter into an operations and maintenance (O&M) contract with the relevant Distribution Utility operating in the area, under which the Distribution Utility takes over responsibility for operating and maintaining the subtransmission assets.
- (iv) In the event that NPC-SPUG continues to own the subtransmission assets, NPC-SPUG shall review and optimize its operating costs, and apply to ERC for a rate increase to cover the full cost of operating and maintaining subtransmission services.



## **Section 5. Additional Functions of NPC-SPUG.**

In addition to its existing functions, NPC-SPUG shall perform the following:

(a) Petition ERC on the proposed regulatory regime aimed at encouraging private sector participation in existing NPC-SPUG areas:

(i) NPC-SPUG will petition ERC to implement a regulatory regime with the following key characteristics:

- (1) NPPs supplying taken-over NPC-SPUG areas may charge the True Cost Generation Rates;
- (2) True Cost Generation Rates shall be established based on competitive bidding to supply at least cost, or in cases where there was not effective competitive bidding, through application of Best New Entrant tariff benchmarking;
- (3) In cases where DOE considers the True Cost Generation Rate too high to be socially acceptable, NPC-SPUG shall petition ERC to set a Socially Acceptable Generation Rate, and for a Missionary Electrification Subsidy to be paid from the UC-ME. The Missionary Electrification Subsidy will be calculated as the difference between the True Cost Generation Rate and the Socially Acceptable Generation Rate;
- (4) The Socially Acceptable Rate may rise over time in line with development of an area, and as a result the Missionary Electrification Subsidy for an area may be set to decline over period;
- (5) When the Socially Acceptable Tariff is equal to or higher than the True Cost Generation Tariff, an area shall be considered Commercially Viable, and NPC-

SPUG shall no longer petition ERC for Missionary Electrification Subsidy for such areas, which will be referred to as having Graduated;

- (6) ERC will be petitioned to determine the Missionary Electrification Subsidy to be provided to the NPP serving the area, and the Socially Acceptable Generation Rate consistent with that subsidy;
  - (7) If a Missionary Electrification Subsidy is provided to the NPP serving an area, the NPP shall be required by regulation and/or the terms of the PSA to reduce its charges to the Distribution Utility commensurate with the subsidy received. The principle is that the tariff revenue and the subsidy should, taken together, be equivalent to the True Cost Generation Rate; and
  - (8) At all times, the NPP serving a taken over NPC SPUG area has the right to charge its True Cost Generation Rate if it does not receive a subsidy which covers the difference between the True Cost Generation Rate and the Socially Acceptable Generation Rate.
- (b) Assist Distribution Utilities operating in existing NPC-SPUG areas to enter PSAs with NPPs.
  - (c) Ensuring that New Missionary Areas are served effectively and efficiently by Qualified Third Parties (QTPs) wherever possible, and by NPC-SPUG directly in the event that no QTPs are willing to serve the area.
  - (d) Ensure payment of the subsidies to entities qualified to avail subsidies from the UC-ME, as determined by the ERC.

#### **Section 6. Non-Retroactivity.**

This Circular does not apply to PSAs where tariff rates have been approved by the ERC before the date of effectiveness of the Circular. *vsp*

**Section 7. Repealing Clause.**

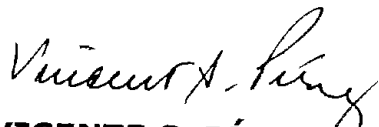
All pertinent issuances, circulars and memoranda inconsistent with this Circular are hereby amended or repealed accordingly.

**Section 8. Saving Clause.**

- (a) If for any reason, any provision of this Circular is declared unconstitutional or invalid, the other parts or provisions hereof which are not affected thereby shall continue to be in full force and effect.
- (b) The implementation of this Circular shall not exempt the parties from applicable laws, rules and regulations.

**Section 9. Effectivity.**

This Circular shall take effect upon its complete publication in a newspaper of general circulation.

  
**VICENTE S. PÉREZ, JR.**  
Secretary

Fort Bonifacio, Taguig, Metro Manila, Philippines, 26 January 2004.