

Report on the Retail Competition Regime in the Republic of the Philippines

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November 10, 2011

Executive Summary

This report is a review of the retail open-access rules adopted by the Energy Regulatory Commission (ERC) of the Republic of the Philippines. These rules were adopted in accordance with Republic Act 9136, the Electric Power Industry Reform Act of 2001 (EPIRA), which called for the restructuring of the electricity sector in the country and the initiation of retail competition. The restructuring involved the privatization of government-owned energy facilities, the establishment of an organized wholesale market for the sale of real-time electricity, and retail open access (or retail competition). The ERC requested that the rules be reviewed by an independent international expert to determine whether they were adequate to support retail competition, prior to the actual initiation of competition. This task is supported by the United States Agency for International Development through the Climate Change and Clean Energy Project.

I spent two weeks in the Philippines meeting with officials of the ERC and the Department of Energy and representatives of private-sector energy companies to get their views on the electricity sector, the rules that have been adopted by the ERC, and whether these rules were adequate to support retail competition. The most significant concerns that were raised during the visit were the inability of the operator of the wholesale spot market to settle the obligations of retail suppliers, the lack of an entity to serve as the central registration agent to maintain a record of the customer-supplier relationships, and the lack of an electronic information system to convey information about a customer's switch from one retail supplier to another and meter data from the distribution utility to the retail supplier and the wholesale market operator.

On June 17, 2011 the Department of Energy issued Department Circular No. 2011-06-0006, creating a Steering Committee that would define the policies for the commencement of Open Access and Retail Competition. The Steering

Committee recommended that the wholesale market operator, the Philippine Electricity Market Corporation (PEMC), develop software solutions that would permit retail suppliers to be settled in the wholesale spot market, that PEMC serve as the central registration agent for the retail market, and that it develop a system for the electronic transmission of switching and meter data.

If the Steering Committee's recommendation is approved, and PEMC moves forward to create the software to perform these functions, it would significantly improve the prospects for retail open access to be successfully implemented in the Philippines. Assuming that PEMC is designated as the responsible agency for this task, it must design, build, and test the systems for settlement, registration, and data communication, and the testing must include testing of communications interfaces between the settlement and registration agency and market participants. The retail open-access rules that have been adopted by the ERC are adequate for the introduction of retail competition, but initiating competition without the settlement, registration, and data communications features discussed above would be extremely challenging.

In addition to recommending that PEMC develop the settlement, registration, and data communications capability, the Department of Energy's Steering Committee recommended that the ERC modify its rules to permit customers to opt out of retail competition. This modification is intended to provide benefits for customers, but it would result in a tilting of the competitive scales in favor of the distribution utility and its affiliated local retail supplier, because the utility would be able to offer the customer an option (regulated service) that a competitive supplier would not be able to offer. Tilting the scales in this manner is likely to deter market entry and disadvantage new retail suppliers that have already entered the market.

There are three areas where the ERC should consider modifications to its rules to enhance retail competition. First, it should consider adopting the same rules for last-resort service for directly-connected customers as it has adopted for contestable customers. Second, it should consider simplifying the requirement in its rules that a retail supplier execute a wheeling contract for each customer it obtains in a distribution utility's service area. Finally, the process in the ERC rules for a retail electric supplier (RES) to obtain a customer's consumption information (with the customer's consent) relies on a registration body that has

not yet been created. The ERC should consider amending its rules to require that the distribution utility provide this information to a RES at no cost or for a cost-based fee, and it should consider requiring the distribution utilities to provide interval-by-interval data if it is available. These recommendations are suggestions for enhancing the existing rules. They do not represent major problems that would preclude opening the retail market when the settlement, central registration, and data communications issues are resolved.

Summary of activities

The original scope of this project was to review the rules for retail competition in the Republic of the Philippines to determine whether they are sufficient to support retail competition as envisioned by Philippine law. During the course of the project other issues emerged, particularly whether additional infrastructure was needed for effective retail competition and whether certain recommendations of a steering committee established by the Department of Energy (DOE), if adopted, would be conducive to a vibrant retail market.

Prior to traveling to the Philippines I met in Texas with Attorney Debora Layugan, Director of the Market Operations Service (MOS) of the Energy Regulatory Commission (ERC), to get a brief summary of the situation in the Philippines. During this meeting, she provided me a copy of the rules for retail competition that have been adopted by the ERC. I reviewed these rules prior to traveling to Manila.

During two weeks in the Philippines (October 17-28), I met a number of persons connected to the electric industry, which afforded me the opportunity to get up-to-date information on developments concerning the introduction of retail competition and hear the views and concerns of a diverse mix of stakeholders and government officials. I met with the ERC, MOS, other ERC staff, Commissioners Yap-Taruc and Non, Secretary of Energy Almendras and two of his Undersecretaries, representatives of a group of companies that have been licensed as Retail Electric Suppliers (RES) by the ERC, and a member of the PEMC staff. At the end of the week, I attended a meeting of the DOE working group. After a week in Manila, I presented my initial conclusions to the Commission at a business meeting on October 24.

The discussions included a number of perspectives on retail competition in the Philippines. The Secretary of Energy raised issues concerning the competitiveness of the wholesale market and the effectiveness of the monitoring of the wholesale spot market. At the same time, he was interested in having retail competition begin and supported the efforts of the DOE Steering Committee, which he believed would enhance the likelihood of successful introduction of retail competition. The Steering Committee and Undersecretary Magpale-Asirit were also working to support the introduction of retail competition, but they proposed two modifications to the market design reflected in the ERC

rules. One of the modifications would be to permit a contestable customer to remain in regulated electric service. The other would allow metering service to be a competitive service. The recommendations of the Steering Committee are addressed below.

Several of the representatives of retail suppliers were eager to have retail competition begin on the schedule originally adopted by the ERC, that is, on December 26, 2011. Some of the representatives argued that large companies in the Philippines face intense competition from companies in other Asian countries, and any measure (such as retail competition) that could reduce their electricity costs would be important for them in maintaining or growing their businesses and in maintaining employment in the Philippines. They also suggested that the definition of contestable customer be expanded to include companies for which electricity is an important cost of production, even if the company's average consumption is less than one megawatt. The retail supplier representatives also suggested that if retail competition were to be delayed, a pilot project for retail competition should be initiated, so that companies that want to have retail access could participate in the pilot project before retail access starts for all contestable customers.

These views represent an important perspective on introducing retail competition in the Philippines. These companies are investing in the retail supply business, and for them to continue to work to be ready to do their part in implementing retail competition, a clear and reasonable timetable established for retail open access should be adopted. However, in my view, the lack of settlement, registration, and data communications mechanisms would create significant risks for retail suppliers. Without the settlement function, it is not clear that a RES could participate in the wholesale spot market or, if it could, that its wholesale obligations could be accurately determined. The lack of a data transmission capability would make it more difficult for retail suppliers to obtain the meter data that would permit them to bill their customers and make it more difficult for the market operator to settle and bill a RES for its spot market obligations. Thus, introducing retail competition without the data transmission feature poses a risk to the retail suppliers that they will have difficulty accurately billing their customers for service. Such an arrangement would also pose a risk to all participants in the wholesale market that they would be assigned spot market costs that should be assigned to a retail supplier. Integrating the wholesale and retail market by providing for retail supplier to have access to the spot market and be accurately settled in it is a very important market feature.

Allowing customers whose average consumption is less than one megawatt to participate in retail competition is a legal and policy issue that would have to be considered by the ERC. Making the retail market larger is one way of making it more attractive to prospective retail suppliers and stimulating market entry, but the definition of contestable customers is presumably based, at least in part, on the statute, rather than the rules of a regulatory agency. Conducting a retail pilot project during the period in which competition is delayed may be feasible. The

risks discussed above would be reduced, because customers and retail suppliers would decide whether they want to take part in the pilot, recognizing the risks involved, and the volume of retail supplier participation in the spot market and volume of meter data that they would need for billing would be less than with full retail competition.

On October 24, I traveled to Cebu for several events and met with a representative of Visayan Electric Company. One of the events in Cebu was a roundtable discussion on retail competition, with a diverse group of stakeholder representatives on the panel and in the audience. In Cebu I also discussed retail competition with representatives of a number of electric cooperatives operating in the Visayas. On October 27 in Manila, a member of the MOS briefed me on the deliberative meeting of the DOE Steering Committee and the recommendations that it planned to make concerning retail competition.

One of the issues raised by representatives of distribution utilities was the prospect of stranded generation costs. The distribution utilities serve their customers' energy needs through contracts with generators and purchases in the wholesale spot market, and with the loss of a contestable customer the distribution utility's generation purchases could exceed its needs, resulting in stranded costs. (Excess energy can be sold in the spot market, but if prices have fallen since the original purchase was made, the loss on the sale of the excess energy would be a stranded cost.) Stranded costs do not reduce the competitiveness of a retail market, but measures adopted to permit utilities to recover stranded costs can be viewed as reducing the potential for customers to benefit from retail competition. I did not review the rules relating to stranded costs, but it is my understanding that utilities have had an opportunity to recover the stranded costs that existed prior to the adoption of EPIRA. With the enactment of EPIRA, the utilities should have understood that retail competition was coming, and they had the opportunity to structure their new generation contracts to take into account the possibility that they would lose customers with the introduction of retail competition.

Retail market evaluation

Evaluation factors

The evaluation presented in this report is based on my experience in implementing retail competition in Texas and on the recommendations and evaluations in the Annual Baseline Assessment of Choice in Canada and the United States (ABACCUS) reports. These reports are comparative evaluations of the effectiveness of retail competition, as implemented in North American states and provinces. Participants in the preparation of the ABACCUS reports included regulators in areas with retail competition and electricity providers who are active in retail markets in North America. (The ABACCUS reports are available at www.defgllc.com/content/Publications/reports.asp.)

Deregulation of the electric industry has typically recognized that the delivery of electricity (transmission and distribution) is and should remain a regulated monopoly, but that the production and retail sale of electricity may be provided on a competitive basis, and that the level of regulation of production and retail sales could be significantly reduced. In the United States, it was common for electricity to be provided by vertically-integrated businesses that produced, delivered, and sold electricity to their customers under an extensive regulatory scheme. The current industry structure in the Philippines consists of a competitive wholesale generation sector, an independent transmission company, an independent market operator for the organized wholesale spot market in Luzon and Visayas, and distribution utilities that buy energy from generators or the spot market and provide regulated retail service within a service area in which they are the only authorized provider.

Introducing competition at the retail level requires the creation of businesses that sell electricity on a competitive basis to end-users of electricity. These new businesses need to buy energy for their customers from producers, obtain transmission and distribution service to deliver it to their customers, obtain meter data to bill their customers, and carry out other standard retail sales functions, such as pricing, marketing, billing, collection, and customer service. Certain of these functions, namely delivery and metering services, are typically to be obtained only from a regulated monopoly.

Introducing retail competition in electricity requires that the entity managing the transition (typically a regulatory agency) identify the key responsibilities of retail suppliers and utilities. Where, as in most cases, an incumbent company retains a role in the retail sale of electricity, it is important to adopt rules to minimize the possibility that the utility will favor the incumbent retail supplier over other retail suppliers and to minimize the opportunities for the utility and incumbent retail supplier (whether they are a single entity or separate entities under common ownership) to use revenue derived from monopoly services to support the incumbent retail supplier's competitive retail market operations. The incumbent supplier typically has significant advantages related to customer good will and name recognition, and the rules for retail competition should not create other advantages of incumbency. Excessive advantages to the incumbent supplier are likely to deter the entry of competitive suppliers into the retail market.

Other areas that need to be addressed relate to the protection of customers. For example, licensing rules should be adopted to require that prospective retail suppliers have the financial, technical, and managerial capability to operate in the retail market. In addition, some provision must be made for customers that do not choose a supplier or whose supplier leaves the market without notifying customers. This is usually referred to as default service or last-resort service. In most businesses, a customer that is notified that a supplier will no longer be providing goods will not have a need to immediately replace the supplier, because the customer may have goods in storage or may be able to defer the purchase of additional goods. In the electricity business, buyers rely on

continuous supply, and meeting the expectation of continuous supply as competition is introduced has been regarded as an important public policy objective.

Finally, retail sales represent the customer end of the market. The production end is also important. Vibrant retail competition depends on a vibrant wholesale market, and the ability of retail suppliers to access that market for supply.

Many of the required regulatory directives that are essential for retail competition are rules of general applicability; thus, they apply to all retail suppliers or all utilities that are providing delivery service for competitive suppliers. Other regulatory directives are applicable to individual entities, such the issuance of a license for a retail supplier, the approval of delivery (or wheeling) rates for a utility, or the approval of the measures a utility has undertaken to ensure that a new entrant to the retail market has access to essential services on the same terms as an incumbent retail supplier. Thus, the prerequisites for effective competition include both rules of general applicability and directives that apply to individual utilities or retail suppliers. The main focus of this report is the rules of general applicability, but it also briefly addresses other regulatory actions that are important in introducing retail competition.

Pre-operational assessment of existing rules and regulations, whether they are sufficient to support retail competition

Definition of responsibilities

The ERC has adopted Rules on Customer Switching that define key responsibilities of retail suppliers, including billing customers and acquiring energy to supply their needs. The switching rules also prescribe:

- a process for switching a customer from one supplier to another;
- a retail supplier's obligations to its customers, including providing accurate bills, refraining from slamming, establishing a dispute resolution process, etc.; and
- marketing rules and customer information standards.

The ERC has also adopted rules that define the responsibilities of distribution utilities, including providing access to transmission and distribution, metering and delivery of meter data to retail suppliers, operation of the distribution system, and initiation and termination of service. These rules are set out in the Amended Distribution Service Open Access Rules.

The Rules on Customer Switching also define the service responsibilities of an independent Customer Registration entity. This entity is responsible for maintaining a record of the relationship between a contestable customer and the Retail Electric Supplier (RES) that is serving the customer and notifying affected retailers when a customer switches from one RES to another. These rules

adequately define the responsibilities of participants in the competitive retail market.

Unbundling and Code of Conduct

The rules that are adopted to ensure that a utility provides service on the same terms to new entrants as to the incumbent retail provider are typically referred to as unbundling rules and a utility code of conduct. The unbundling rules describe how the utility that, under a regulated monopoly regime, provides both distribution and retail services is to transition to a utility that provides regulated delivery (or wheeling) service to all retail suppliers and how customers that do not or cannot switch to a competitive retail supplier continue to be served by the utility or a retail supplier that is affiliated with it. The code of conduct is a set of prohibitions that are intended to preclude discrimination in favor of a competitive affiliate of the transmission or distribution utility.

In the Philippines model, in the first stage of competition only the customers with a very high volume of electricity consumption (at least one megawatt) may avail themselves of retail competition. The utility continues to provide regulated, bundled retail service to all of the customers with lower levels of consumption. In addition, the rules define a Supplier of Last Resort (SOLR) that provides service to contestable customers who do not choose a RES or whose RES stops providing service to them and fails to provide sufficient notice for the customer to obtain another supplier. In the initial stage of competition, the utility provides the SOLR service. In addition, the utility may create a Local RES that may compete to provide retail service to customers within the utility's service area.

The ERC has adopted several sets of rules to define the unbundling process, establish general obligations of a utility that is providing open-access distribution service, and establish operating rules for the utility, including the Business Separation Guidelines, the Code of Conduct, the Amended Distribution Service Open Access Rules, Rules for the Supplier of Last Resort for the Contestable Market, and the Competition Rules and Complaint Procedures. These rules are based on the recognition that without a separation of the utility function from the competitive function, there would be opportunities for anti-competitive behavior, discrimination against new market entrants, and subsidization of the utility affiliate's competitive business by captive customers or regulated services. These behaviors, if permitted, could handicap new market entrants, deter market entry, increase costs for captive customers, and impair the effectiveness of retail competition. The ERC's rules are adequate in addressing unbundling and code of conduct issues.

Supplier of last resort

The ERC has issued rules that establish that at the start of retail competition, the distribution utility that has captive customers is the SOLR, and that the SOLR will serve customers who do not choose a RES and customers whose RES stops providing service without sufficient notice to the customer. These rules are set out in the Rules for the Supplier of Last Resort for the Contestable Market. The rules make it clear that the SOLR service is not a competitive service, and the pricing rules for SOLR service permit a distribution utility to price SOLR service on the basis of the prices in the wholesale energy market. This is a reasonable pricing arrangement, because the short and unpredictable term of SOLR service makes it impractical for a SOLR provider to rely on a bilateral purchase to supply the SOLR customer. In general, the SOLR rules are adequate for retail competition. The discussion below points out two areas where modifications to the rules may be appropriate.

As is noted above, the SOLR rules provide that the SOLR price may be based on the prices in the wholesale spot market. In fact, a mark-up of the SOLR prices above the spot market price is appropriate, because of the costs and risks that the provider faces in supplying a SOLR customer, and the ERC rule permits the SOLR rate to include a premium above the wholesale market rate. Article VII, Section 3 of the SOLR rules also permit the SOLR provider to carry over unrecovered costs of providing the service. This provision is problematic if customers remain on SOLR service for only a short period, because the delay in implementing the recovery of expenses that are carried over would mean that customers for whom the additional costs were incurred would not be charged. Instead, subsequent SOLR customers would be charged for such costs. It may be preferable to make it clear that the premium permitted in the SOLR rate addresses all costs and risks of any cost elements that is not otherwise provided for in the rule, so that SOLR customers are charged for all of the costs and risks associated with providing SOLR service, without any subsequent true-up.

One unresolved issue relating to SOLR service is the designation of a SOLR for directly-connected customers. These customers already effectively have competitive rates, because they are not regarded as being located in a distribution utility's service area and have access to the wholesale market. When retail competition is introduced more broadly, it probably makes sense to have uniform rules for the market, so that these customers would be required to obtain supply from a RES and have a SOLR designated for them.

Licensing

Licensing rules should be adopted to require that prospective retail suppliers have the financial, technical, and managerial capability to operate in the retail market. These rules are primarily intended to protect customers by keeping out of the market companies that do not have the capability to meet the obligations they make to customers, because they do not have the knowledge or financial resources to make sound retail pricing decisions, acquire energy to serve their

customers, or switch and bill customers. Retail suppliers that do not have adequate knowledge and financial resources may also pose a risk to participants in the wholesale market if they buy power either in the organized wholesale market or on a bilateral basis and are not able to pay for it when payment is due. The ERC has adopted Revised Rules for the Issuance of Licenses by Retail Electricity Suppliers that address the operating risks of the retail market, and PEMC has the authority to address the credit risks of operating in the wholesale market.

Integration of retail and wholesale market, infrastructure issues

Retail suppliers must buy energy to meet their customers' needs, just as in the regulated environment distribution utilities buy energy to meet their customers' needs. In the aggregate, energy supplied must at all times equal the energy produced, as electricity storage is not a part of the current technology environment of the electric power industry. Ideally, the RES or distribution utility that is supplying customers should have a financial obligation to match its customers' supply to their demand over time and in each interval in which its customers consume electricity. One of the features of any wholesale market is price variability, with typically a daily and seasonal variation of prices that follow the daily variation of aggregate demand and the daily and seasonal variation of demand and resource availability. For the sake of efficiency, each retail supplier should be assigned the costs of serving its customers, based on their actual consumption in both high- and low-price periods.

The RES or distribution utility will normally have bilateral contracts to supply customer demand, but the energy procured from bilateral purchases may not match customer demand at all times. Organized real-time energy markets provide retail suppliers and distribution utilities a place to buy additional energy if the bilateral contracts do not supply sufficient energy to meet customer demand and a place to sell any bilateral energy that is excess to their customers' demand. Having a real-time wholesale energy market is a major advantage to retail suppliers and is a feature that enhances the efficiency of the market. If such a real-time wholesale market exists, it is important that the market operator be able to settle the wholesale market obligations of a RES in the same manner that it settles the obligations of a distribution utility. The ability to settle the obligations of a RES in the real-time market is an important feature that is lacking in the current market infrastructure in the Philippines. The rules issued by the ERC contemplate that a RES would be able to trade in the real-time market, but the settlement software of the Wholesale Electricity Spot Market (WESM) needs to be modified to facilitate RES trading and settlement of RES obligations in this market. The market operator (PEMC) would also need to modify any market rules that are a barrier to RES participation in the wholesale spot market on equal terms with distribution utilities.

A second important feature that is contemplated by the ERC rules but not currently in operation is an electronic system for the communication of key market information among retail suppliers, distribution utilities, and the wholesale

market operator. At a minimum, this electronic communication system should be able to convey information about the switching of a customer from one RES to another and meter data. It is probably desirable that the communication system be able to transmit other information, such as initiation and termination of service by a customer. The electronic communication of meter data is important to convey to a RES the information it needs to issue bills to its customers, and to permit the wholesale market operator to settle the RES's obligations in the real-time market. The electronic communication of switching information also supports the wholesale settlement, and it is important as a means to let a RES know that it is no longer responsible for serving a customer, so that it can modify its wholesale energy purchases to reflect the loss of the customer. If a customer switches from one RES to another, the gaining RES is aware of the transaction and recognizes the need to acquire energy to serve that customer. The RES that is losing the customer may not be aware of the loss, however. The electronic data system provides this notice and permits the RES to reduce its energy purchases to recognize the loss of the customer.

The third infrastructure feature that is contemplated by the ERC rules but not currently in operation is a central registration function. The central registration is, in effect, the official list of the customers that are served by each RES. Central registration facilitates the wholesale settlement of RES obligations and the transmission of meter data to the RES that needs it to bill its customers.

The DOE is leading an effort through a Steering Committee of interested energy agencies to develop a mechanism for providing these functions. The Steering Committee has received a proposal from PEMC to carry out the settlement and registration functions and to create an electronic communications system for retailers and other key market participants. At a meeting on October 26, the Steering Committee recommended that the PEMC proposal be adopted.

To move from the recommendation of a proposal for these functions to a workable solution, the responsible agency must be approved, and it must design, build, and test the systems for settlement, registration, and data communication. The required testing includes testing of communications interfaces between the settlement and registration agency and market participants. A key element in identifying and approving the responsible agency to build these systems is identifying a mechanism for funding the initial costs and recovering both the initial costs and ongoing operating expenses from appropriate market participants. While PEMC has submitted a proposal to develop the systems, and the DOE Steering Committee has recommended that PEMC be designated to carry out the development, it is not clear that a source of funding for the development of the systems has been identified. In addition, it appears that the ongoing funding of these functions and the recovery of the initial investment would need to be approved by the ERC.

DOE Steering Committee recommendations

In addition to recommending that PEMC develop and operate the systems that would permit it to settle the obligations of a RES in the wholesale spot market, the electronic communications system, and the central registration function, the DOE Steering Committee has recommended two modifications to the market design that is reflected in the ERC rules. The Rules for Contestability establish that the initial contestable customers, those with average consumption of at least one megawatt have two options, to buy energy from either a RES or Local RES. Under one of the modifications recommended by the Steering Committee, a contestable customer could elect not to participate in the competitive retail market and, rather, remain in regulated service. The ERC rules also provide for metering service to be provided as a regulated service by the distribution utility. The second Steering Committee recommendation would permit metering service to be provided on a competitive basis. These recommended modifications are analyzed below.

Opting out of competitive service

Two factors that contribute to the competitiveness (and likelihood of success) of a deregulated electricity market are the breadth of that market and the extent to which the market design eliminates the potential for discrimination by the utility that is providing essential services on a regulated basis or by its competitive affiliate. Allowing customers who would otherwise be a part of the competitive market to avoid the market entirely by electing a regulated service would be detrimental to the competitiveness of the market, because it would reduce the size of the market in terms of number of customers and load served and it would disadvantage competitive retail suppliers.

The market design embodied in the ERC rules requires that, at the start of retail competition, distribution utilities continue providing service to customers who do not meet the size qualification for contestable customers. The distribution utilities may also create a local RES to compete for the business of contestable customers in their service areas. Finally, the ERC has established rules for SOLR service, which will initially be provided by the distribution utility. The distribution utility and its affiliated RES, the local RES, have three sources of revenue that might be used to support the competitive activities of the local RES. Revenue from the operations of the local RES can legitimately be used to support this business, but revenue from the captive customers and SOLR service should not be used to support the competitive local RES.

While the unbundling rules and code of conduct are designed to prevent the subsidization of the competitive business by revenue or logistical support from the regulated business, the effectiveness of these rules is dependent on compliance with these rules and the ERC's oversight and monitoring of the rules. Allowing contestable customers to opt to remain in regulated service with the distribution utility creates another potential source of improper cross-subsidization, namely, the revenue from customers who opt to remain in

regulated service could be used to support the local RES in providing competitive services to customers who opt to enter the retail market.

From the customer's perspective, the power to choose to remain in regulated service may be a valuable option. Providing a regulated or partially-regulated option is particularly relevant in connection with customers who may be expected to have little knowledge of the introduction of competition and little interest in switching suppliers. Thus, in Texas a partially-regulated rate was established for residential and small commercial customers for the first five years of retail competition. For these customers, it may be assumed that there is a long education period concerning retail competition, and that a protective rate is appropriate. Even for these customers, however, the Texas rules did not permit them to completely opt out of competition.

Giving the customer a regulated or partially-regulated option has a cost; it gives the distribution utility and its affiliated local RES a competitive advantage over new market entrants. A new market entrant would not be able to give the customer this valuable option. This is a case where a market feature that is intended to provide benefits for customers results in a tilting of the competitive scales in favor of the distribution utility and its local RES. Tilting the scales in this manner is likely to deter market entry and disadvantage new RES businesses that have already entered the market. Moreover, there is much little policy justification for a regulated or partially-regulated rate for customers who are spending millions of pesos on electricity, presumably are sophisticated buyers of other goods and service, and have every incentive to understand their options and choose a competitive supplier.

The steering committee's runs counter to two recommendations in the 2010 ABACCUS report for establishing competitive retail electricity markets. These recommendations include the following:

- Allow all electricity consumers in the jurisdiction to participate in a competitive retail electricity market.
- Establish a plan for the separation of regulated services from competitive services, and for the application of a strict code of conduct to govern interactions between the regulated utility and its competitive affiliates.

The ABACCUS report represents the conclusions of a group of North American regulators and representatives of retail companies with experience in electricity competition in North America, concerning best practices for designing retail markets. (Available at [www.defgllc.com.content/Publications/reports.asp](http://www.defgllc.com/content/Publications/reports.asp).)

Competitive metering

The DOE Steering Committee has also recommended that the ERC adopt rules to permit competitive metering. While this recommendation is not as problematic as the recommendation concerning opting out of competition, it is likely to require ERC resources to develop the rules, with little likelihood that competitive metering companies would enter the market. To establish a metering business

on a competitive basis would require a new market entrant to obtain and sell or lease meters that are compliant with the ERC rules, establish a logistical support network to install and service the meters, and have either personnel or electronic communications systems to read the meters, verify the data, and transmit it to the RES and the wholesale market operator. It is difficult to imagine a competitive metering company being able to carry out these functions in a way that the price for the service would be competitive with the regulated rate of the distribution utility. The distribution utilities have significant scale in performing the metering function that a new market entrant would be unable to match. In the Texas retail market, it was originally envisioned that metering would be a competitive service. Competitive providers never indicated an intention of providing the service, and the legal provisions on competitive metering were later repealed. Texas utilities are in the process of deploying advanced meters in competitive areas, but these meters are being deployed as regulated, rather than competitive, services.

Technological developments in meters might afford a new entrant in the metering business an opportunity to provide meters with more capabilities than standard meters in use in the Philippines today, but the requirements for installing and servicing a small number of meters, compared to the scale of service afforded by the distribution utilities, would be a significant pricing challenge for a new entrant.

While it is not likely that new entrants could make a successful business of metering for contestable customers, developing the rules to permit competition in metering is not likely to adversely affect the retail market. It would, however, require the ERC to commit resources to a project that is not likely to provide benefits to the retail market.

Other requirements

Apart from the adoption of rules for the retail market, there are other requirements that should be met before retail competition begins. The following are such requirements:

- Operation of competitive wholesale market;
- Setting rates for transmission and distribution (wheeling) service;
- Licensing of retail suppliers;
- Review of compliance with distribution utility unbundling requirements; and
- Testing of information flow for switching and billing.

The first four of these milestones have been met. The development of the electronic communications system should include testing of the system, including testing of its capability to accurately transmit information from one market participant to another.

Pre-operational assessment of market in terms of entry and exit of market participants

The licensing rules appear to be appropriate for ensuring that entry into the retail supply market is controlled to preclude the entry of firms that would not be capable of operating in the market. At the same time, the rules do not appear to raise inappropriate barriers to entry into the market. No concerns were raised in this area in meetings with stakeholders.

Pre-operational assessment of submission and compliance mechanisms of market participants

The reporting and compliance mechanisms in the ERC's rules appear to be adequate. During discussions with the MOS staff, I discussed the monitoring of the retail market by the Texas Public Utility Commission and suggested areas that the ERC might consider for additional reporting. These areas include establishing performance measures for data flow in the electronic information system and reporting by users of the system on the degree of their compliance with the performance standards and reporting on the number of customers who switch to a competitive RES and the level of energy consumption and load associated with customers who switch. No other issues with regard to reporting and compliance were noted.

Pre-operational assessment of the customer switching process

The switching provisions of the ERC's rules appear to be adequate. As is noted above, PEMC has proposed that it build an electronic mechanism to convey switching and meter data between market participants. This proposal, if approved and created, would significantly enhance the likelihood of successful introduction of retail competition. At this point, however, there is not sufficient information available on the details of the system for the electronic data transmission to permit me to comment on its adequacy.

Recommended enhancements, if needed

The development of systems to permit the obligations of a RES to be settled in the real-time market, a central registration system, and a system for electronic transmission of important information among distribution utilities, retail suppliers, and the market operator are important enhancements that should be made, and it appears that the ERC and DOE recognize the importance of implementing these systems.

The switching rules appear to contemplate that a RES would execute a wheeling agreement with a distribution utility whenever the RES gains a customer. In discussions with the MOS staff, I suggested that executing individual wheeling contracts each time a RES gains a customer would be cumbersome. There are alternative arrangements that the ERC may wish to consider, such as blanket wheeling contracts that cover any customers a RES may have with a particular

distribution utility or establishing detailed wheeling tariffs, so that a RES taking wheeling service would not need to execute a contract for the service.

An issue that arose in discussions with MOS staff and in the meeting with retail suppliers concerned the availability of consumption data to a customer and a RES that seeks to provide service to the customer. This information is important to the RES in analyzing the costs that would be incurred in providing service to the customer, and thus in developing a pricing proposal for the customer. The Rules on Customer Switching provide that the customer may authorize the Central Registration Body to release consumption information to a RES or local RES.

As is discussed above, the Philippines has not established a Central Registration Body, so the information on customer consumption would not be available from this source. The other issue is that the Rules on Customer Switching permit the RES to obtain the energy consumption for each month. In contrast, the 2010 Amended Distribution Service Open Access Rules require interval metering for retail competition, presumably so that the customers' obligations in the wholesale market may be settled on an interval-by-interval basis. To accurately estimate a customer's energy costs, a RES will need interval consumption data. The ERC should consider requiring the distribution utilities to make customer consumption available to a RES, when authorized by the customer. The customer's consumption data should include interval data if it is available. This information is not readily available except from the distribution utility. For a RES, access to the information is important to facilitate making competitive offers to customers, and the provision of the service by a distribution utility should be regarded as a regulated service associated with its current regulated retail service. The distribution utilities should be required to provide this information at no cost to the RES or for a cost-based fee.

Review of B2B system and transitory structure, including recommended enhancements

As is noted above, PEMC has proposed that it build an electronic mechanism to convey switching and meter data between market participants. This proposal, if approved and carried out, would significantly enhance the likelihood of successful introduction of retail competition. At this point, however, there is not sufficient information on the details of the system for the electronic information transmission to permit me to comment on their adequacy. The transitory rules were envisioned as rules to facilitate switching without a central registration system or electronic system for data transmission. In view of the DOE Steering Committee's recommendation to develop these features and the ERC's decision to delay retail competition beyond December 26, 2011, it appears that the switching provisions of the transitory rules are now largely moot.

Disclaimer:

This report is done by an independent Subject Matter Expert engaged for the purpose of evaluating the adequacy of the Rules and Regulations relative to the Competitive Retail Electricity Market of the Philippines