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PHILIPPINES

LAW AND PRACTICE:

p.3

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Law and Practice

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PHILIPPINES LAW AND PRACTICE

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Cruz Marcelo & Tenefrancia is a full-service law firm based in Bonifacio Global City, Taguig City, composed of more than 70 lawyers specialising in various fields including corporate and special projects, dispute resolution, intellectual property, energy, and mining and natural resources.

Founded in 2013, CMT is built on the 38-year legal practice of its founding partners and is staffed by lawyers with specialised degrees in the hard sciences and engineering, among others.

Author



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1. General Structure and Ownership of the Power Industry

1.1 Principal Law Governing the Ownership and Structure of the Power Industry

The principal laws that govern the Philippine power industry are the Department of Energy Act of 1992 (Republic Act No 7638), the Electric Power Industry Reform Act of 2001 (Republic Act No 9136 or the EPIRA) and the Renewable Energy Act of 2008 (Republic Act No 9513). The foregoing are, in turn, implemented through rules and regulations and other administrative issuances of the Department of Energy (DOE) and the Energy Regulatory Commission (ERC).

The Philippine power industry is divided into four major sectors: generation, transmission, distribution, and supply. Generation used to be a monopoly of the National Power Corporation (NPC) until the issuance of Executive Order No 215, which opened the generation sector to private investors. At present, a number of independent power producers (IPP) generate and sell electricity to the NPC and other customers.

Pursuant to the EPIRA, the electrical transmission functions of the NPC have been assumed by the National Transmission Corporation (TRANSCO), a corporation previously wholly owned by the Power Sector Assets and Liabilities Management Corporation, a government-owned and controlled

corporation that has taken ownership of all existing NPC generation assets, liabilities, IPP contracts, real estate and all other disposable assets. In 2009, TRANSCO was privatised and taken over by the National Grid Corporation of the Philippines (NGCP). However, TRANSCO remains the owner of the transmission assets.

Distribution of electricity at its useable voltage to end-consumers is performed by investor-owned electric distribution utilities, notably the Manila Electric Company (Meralco), a few local government-owned utilities and numerous electric co-operatives that sell to households, as well as commercial and industrial enterprises located within their franchise areas at retail rates regulated by the ERC.

The supply of electricity to end-users in the contestable market requires a licence from the ERC, except for the supply of electricity by distribution utilities within their franchise areas and persons authorised to supply electricity within their respective economic zones. A contestable market refers to electricity end-users who have a choice of a supplier of electricity, as may be determined by the ERC in accordance with the EPIRA.

1.2 Principal State-Owned or Investor-Owned Entities

Aside from the government agencies and private corporations mentioned above, some of the other major players in the Philippine power industry are as follows:

- Aboitiz Power Corporation;
- SMC Global Power Holdings Corporation;
- Energy Development Corporation;
- Global Power Corporation;
- SEM-CALACA Power Corporation;
- AES Philippines;
- Electricity Generating Public Company International Co. Ltd. (EGCO);
- TeaM Energy Corporation.

All of the above are privately-owned corporations.

1.3 Foreign Investment Review Process

In general, the Philippine Constitution and specific statutes reserve certain businesses and activities for Filipino citizens, including juridical entities. There is a statutory injunction that only citizens of the Philippines or corporations or associations which are at least 60%-owned by Filipino citizens may have the control and management of a specified right, franchise, privilege, property or business. One such case is that of public utilities, which is reserved for Filipino citizens or corporations or associations which are at least 60%-owned by Filipino citizens. In cases of very significant public interest the percentage requirement may be higher, sometimes reaching 100%.

In the Philippines, participants in the transmission and distribution sectors are considered public utilities and must obtain franchises from congress. It must be noted, however, that this limitation applies only to the operation and management of public utilities, not to ownership of the equipment involved. Thus, it is possible for a wholly foreign-owned corporation to own, for instance, transmission lines and substation facilities, and for the operation and management of the same to belong to another constitutionally qualified corporation.

However, the generation and supply sectors of the Philippine electricity industry are not considered public utilities and therefore are not subject to foreign ownership limitations. This notwithstanding, the DOE currently awards service/operating contracts involving the exploration, development, production and utilisation of renewable energy and hybrid systems only to citizens of the Philippines or to corporations or associations in which 60% of the capital is owned by such citizens. Under the Securities and Exchange Commission (SEC) Memorandum Circular No 8, Series of 2013, for purposes of determining compliance with the nationality restrictions, the required percentage of Filipino ownership

shall be applied to both the total number of outstanding shares of stock entitled to vote in the election of directors and the total number of outstanding shares of stock, whether or not entitled to vote in the election of directors. Renewable energy contracts involving geothermal energy in the nature of a financial or technical assistance agreement, however, remain open to foreign applicants.

With regard to being afforded resort to domestic courts, the Philippine Corporation Code provides the following:

- A foreign corporation that is doing business in the Philippines, as defined in Philippine case law, and is registered with the Philippine Securities and Exchange Commission (SEC), may file suit in the Philippines. In the leading case of *Mentholatum v Mangaliman* (G.R. No L-47701, 27 June 1941), doing business in the Philippines was defined as a foreign corporation “*continuing the body or substance of the business or enterprise for which it was organised in the Philippines*”. The Philippine Supreme Court further stated that the term “*implies a continuity of commercial dealings and arrangements, and contemplates, to that extent, the performance of acts or works or the exercise of some of the functions normally incident to, and in progressive prosecution of, the purpose and object of its organisation*”.
- A foreign corporation that is not doing business in the Philippines (as defined above) and not registered with the SEC may likewise file suit in the Philippines.
- Furthermore, as early as the case of *People v Chan Fook* (G.R. No L-16968, 6 October 1921), it has been held that foreigners sojourning in the Philippines are entitled to the protections afforded by the bill of rights in the Philippine Constitution. Likewise, the Philippine Constitution (Article II, Section 2) provides that the Philippines adopts the generally accepted principles of international law as part of the law of the land and adheres to the policy of peace, equality and justice, freedom and cooperation and amity with all nations. Lastly, this jurisdiction recognises the freedom of the parties to a dispute to make their own arrangements to resolve such disputes (Section 2 of Republic Act No 9285, also known as the Act to Institutionalise the Use of an Alternative Dispute Resolution System in the Philippines and to Establish the Office for Alternative Dispute Resolution, and for Other Purposes) including resort to international arbitration.

Generally, under Book I of Executive Order No 226 (the Omnibus Investments Code of 1987), a qualified enterprise may enjoy certain benefits and incentives provided it invests in preferred areas of investments enumerated in the Investments Priorities Plan issued annually by the Philippines’ Board of Investments (BOI).

Upon registration with the BOI, a qualified enterprise is entitled to the following fiscal and non-fiscal incentives:

- fiscal incentives:
 - (a) income tax holiday;
 - (b) exemption for taxes and duties on imported spare parts;
 - (c) exemption from wharfage dues and export tax, duty, import and fees;
 - (d) modified duty rate for capital equipment by virtue of Executive Order No 313, as modified by Executive Order No 528;
 - (e) tax credits; and
 - (f) additional deductions from taxable income.
- non-fiscal incentives:
 - (a) employment of foreign nationals;
 - (b) simplifications of customs procedures;
 - (c) importation of consigned equipment;
 - (d) privilege to operate bonded manufacturing/trading warehouses, subject to customs rules and regulations.

1.4 Principal Law Governing the Sale of Power Industry Assets

Under the EPIRA (see 1.1 **Principal Laws Governing the Ownership and Structure of the Power Industry**, above), a corporation may apply with the ERC for clearance to be allowed to merge with another corporation. The ERC shall grant the application if it determines that the merger will not, or is not likely to, have the effect of substantially lessening competition in a market. Where the ERC has granted an application for a clearance, the grantee must not directly or indirectly acquire the shares or assets, or undertake the merger or consolidation, until the expiry of the period ending 60 days after the proposed merger has been made public, or such shorter period as permitted by the ERC.

A corporation may likewise apply with the ERC for an authorisation to merge or consolidate with another corporation, which merger or consolidation would result in lessening competition in the market. The ERC shall grant the application if it determines that the acquisition, merger or consolidation will benefit, or is likely to benefit, the public and which outweighs the detriment to the public caused by the lessening of competition that would result. No clearance or authorisation will be issued if the merger was made before the ERC decides on the application for clearance.

The requirements for the application are provided by Rule 20(D) of the ERC's Rules of Practice and Procedure. Upon filing of the application with the ERC, the commission may, on its own or upon motion, grant the issuance of a Provisional Authority (PA) based on the allegations of the application and on such other documents attached thereto or submitted by the parties. The ERC, if necessary, may schedule a hearing for the issuance of a PA not later than 30 days from the filing of the application. Thereafter, the commission shall issue a ruling either granting or denying the PA, stating clearly the reasons within 75 days from the filing of the application. The

application shall be decided by the ERC within 90 days from the time the applicant formally offers its evidence; otherwise, the application shall be deemed approved upon the lapse of said period.

The Philippine Competition Act (Republic Act No 10667), which was signed into law by then President Benigno S. Aquino III on 21 July 2015, likewise granted the Philippine Competition Commission (PCC) the power to review mergers and acquisitions, including those of public utilities. In general, parties to a merger or acquisition with a transaction value of more than PHP1 billion are prohibited from completing their agreement until 30 days have lapsed from notifying the PCC. Any agreement completed in violation of the foregoing is void, and shall subject the parties to an administrative fine of 1–5% of the transaction value. The Implementing Rules and Regulations of the Philippine Competition Act (Philippine Competition Act IRR) provide that a favourable recommendation by a government agency with a competition mandate shall give rise to a disputable presumption that the proposed merger or acquisition does not violate the Philippine Competition Act.

The Philippine Competition Act prohibits mergers and acquisitions that substantially prevent, restrict or lessen competition in the relevant market. In the Philippine Competition Act IRR, parties to a merger or acquisition that satisfy the thresholds for compulsory notification are required to notify the Philippine Competition Commission (PCC) before the execution of the definitive agreements relating to the transaction.

As stated above, the Philippine Competition Act prohibits parties to a merger or acquisition wherein the value of the transaction exceeds PHP1 billion from completing their agreement until 30 days after providing notification to the PCC. After determination by the PCC that all the relevant requirements for the said notification have been submitted, the PCC shall issue a notice to the parties that the notification is sufficient for purposes of commencing Phase 1 review. Once the notice has been issued, the abovementioned 30-day waiting period commences. After the Phase 1 review, the PCC determines whether there is a need for a more comprehensive and detailed analysis of the merger or acquisition under a Phase 2 review. If the PCC determines that a Phase 2 review is necessary, it shall request other information or documents relevant to its further review. Upon receipt by the parties of the said request, the 30-day waiting period is extended for an additional 60 days, but the total period of review shall not exceed 90 days. Ultimately, the PCC shall decide on the legality of the merger or acquisition agreement and it may either approve or prohibit the implementation of such agreement. Note, however, that when the 30-day waiting period (extendible for an additional 60 days but not exceeding 90 days for the Phase 2 review) has expired and no

decision has been promulgated by the PCC, the merger or acquisition agreement is deemed approved and the parties may proceed to implement or complete it.

1.5 Central Planning Authority

Power transmission in the Philippines is a common carrier business (ie, it is regulated by the government, serves its franchise area without discrimination, and is responsible for any losses incurred during delivery). It is regulated by the ERC which has rate-making powers and the final say in the valuation of transmission assets. Currently, the NGCP has control of national transmission and, assuming it secures a renewal of its congressional franchise, the same will end on 1 December 2058. Unlike outright sale, the concession agreement allowed the government to keep ownership of the transmission assets through TRANSCO, in accordance with Section 8 of EPIRA which states that no entity, company, or person other than TRANSCO shall own any transmission facilities. TRANSCO is also responsible for making sure that NGCP complies with the standards set by its congressional franchise.

The ERC is the independent, quasi-judicial body created under the EPIRA with the mandate to, among other things, establish and enforce a methodology for setting transmission and distribution wheeling and retail rates for the captive market of a distribution utility, taking into account all relevant considerations, including the efficiency or inefficiency of regulated entities. In addition, it also has the specific mandate to monitor activities in the generation and supply of electric power industry with the end view of promoting free market competition and ensuring that the allocation or pass-through of bulk purchase cost by distributors is transparent and non-discriminatory.

1.6 Material Changes in Law or Regulation

There has been no new significant legislation passed in 2018 affecting the power industry. However, several bills have been filed and are currently pending in the 17th Congress (25 July 2016-2019), with the common goal of initiating and promoting the use and development of renewable energy resources. For instance, a bill promoting the reduction of electricity rates through the utilisation of the government share in the discovery and development of indigenous sources of energy for the purpose of lowering the cost of electricity was filed on 26 July 2016 and is now pending with the Committee on Energy. Other recently filed bills include bills institutionalising energy efficiency and conservation and granting incentives to energy efficiency and conservation projects, a bill requiring all government and non-government offices and establishments to adopt policies for energy conservation, and a bill requiring the use of energy-efficient lighting products. Bills proposing the creation of a Philippine Solar Initiative Commission and the establishment of a Solar En-

ergy Development Authority were re-filed in the 17th Congress and have been pending since 1 August 2016.

It has recently been reported in various news publications that the ERC has approved a higher 2017 feed-in-tariff allowance (FIT-All) rate of PHP0.2563 per kilowatt-hour (kWh) up from the previous rate of PHP0.1830 per kWh.

The FIT-All is a uniform charge billed to all on-grid electricity consumers, reflected as a separate component of the monthly electricity bills. This is meant to cover incentive payments to renewable energy developers/generators under the FIT system. These payments are placed into a FIT-All Fund managed by the TRANSCO.

It has been reported that in its decision to increase the FIT-All rate, the ERC opined that there is a need to increase the FIT-All rate to address the inability of the FIT-All fund to pay the claims of the FIT-eligible generators.

A local consumer advocacy group, which had earlier intervened in the rate case, has indicated that they will appeal this decision once they formally receive their copy of the decision. This same group had mounted a similar challenge against the ERC's decision to increase the 2016 FIT-All rate.

Notably, under the ERC's Rules of Practice and Procedure, all ERC final orders and decisions are immediately executory unless enjoined by an appellate court.

1.7 Announcements Regarding New Policies

On 30 December 2017, the DOE issued Circular No DC2017-12-0015, or the Renewable Portfolio Standards (RPS) On-Grid Rules, which required distribution utilities (DUs), electricity suppliers, generating companies supplying directly connected customers, and other mandated energy sector participants to source or produce a certain share of electricity from their energy mix from eligible renewable energy (RE) sources. These eligible RE facilities include biomass, waste-to-energy technology, wind, solar, hydro, ocean, geothermal, as well as other RE technologies that may be identified by the DOE.

The implementation of the RPS is an important development for the renewable energy market, and impacts the public as a whole. Republic Act No 9513 (the Renewable Energy Law) gives both fiscal and non-fiscal incentives to investors in order to encourage the promotion and development of renewable energy in the Philippines. Toward this end, the RPS serves as a market-based policy mechanism which makes use of the RE market to facilitate and commercialise trading in RE Certificates, which are used to satisfy the RPS requirements and increases RE generation in the country.

1.8 Unique Aspects of the Power Industry

An aspect that should be considered by anyone seeking to invest in the Philippine power sector is how the country's geography shapes its power sector. Electricity rates in the Philippines are among the highest in the ASEAN region, due in large part to the country's dependence on imported fossil fuel. The Philippines' electricity issues are connected to its geography: the country consists of more than 7,000 islands, many of which are small and have been traditionally served by generators powered by imported diesel fuel. The different islands frequently experience rolling blackouts and unplanned power outages due to grid instability and inadequate generation capacity that can be traced to the expensive cost of fuel.

Philippine geography also affects the applicability of renewable sources of energy in the country, the adoption of which is meant to counter the prohibitive cost of fuel. An example of this was revealed with early studies of the country's offshore wind potential. In other countries, particularly in Western Europe, offshore wind turbines are being used to harness the energy of strong, consistent winds that are found over the oceans – offshore winds tending to blow harder and more uniformly than on land. The potential energy produced from wind is directly proportional to the cube of the wind speed. As a result, increased wind speeds of only a few miles per hour can produce a significantly larger amount of electricity. For instance, a turbine at a site with an average wind speed of 16 mph would produce 50% more electricity than at a site with the same turbine and average wind speeds of 14 mph. However, the presence of shallower waters in the Atlantic makes development more attractive and economical. By comparison, these same studies reveal that the deep waters surrounding the Philippines have made the adoption of offshore wind turbines impractical and even dangerous.

To be clear, investors are still studying the applicability of offshore wind energy and this example is meant to show how the Philippines' particular geography must be taken into account in utilising and translating foreign solutions to the country's energy issues.

2. Market Structure, Supply and Pricing

2.1 Structure of the Wholesale Electricity Market

Electricity rates are determined by the Philippine Electric Market Corporation via trading through the Wholesale Electricity Spot Market (WESM), which is a venue where electricity made by power-producing companies is centrally co-ordinated and traded like any other commodity, and prices are driven by the law of supply and demand. WESM was established by the DOE pursuant to the EPIRA.

As a wholesale market, it is open to distributors, directly connected customers, large users, and supply aggregators. As a spot market, electricity is traded on a real-time basis or “on-the-spot”.

The DOE has formulated the detailed rules for the WESM jointly with the electric power industry participants. The rules provide the mechanism for determining the price of electricity not covered by bilateral contracts between sellers and purchasers of electricity. Customer nodes are grouped into customer pricing zones. All customers within a customer pricing zone pay the same price for electricity consumed.

2.2 Imports and Exports of Electricity

There are no rules yet on cross-border electricity supply or cross-border electricity purchases. Nevertheless, the Philippines is a signatory to the 2007 Memorandum of Understanding on the ASEAN Power Grid which aims to strengthen efforts in the implementation of the proposed ASEAN Power Grid through cross-border electricity interconnection of ASEAN member economies. According to the NGCP, efforts are being undertaken to accomplish a transmission development plan to prepare the Philippines for power interconnection with the ASEAN power grid in the coming years. It has currently filed for a provisional authority with the ERC to conduct a feasibility study for the interconnection project.

2.3 Supply Mix for the Entire Market

Based on the DOE website (www.doe.gov.ph), the total dependable electric capacity of the Philippines in terms of percentage is:

- coal – 34.40%;
- hydro – 19.07%;
- natural gas – 17.66%;
- oil-based – 17.30%;
- geothermal – 10.28%;
- wind – 0.66%;
- biomass – 0.52%;
- solar – 0.11%.

The percentage of installed capacity is broken down as follows:

- coal – 31.81%;
- hydro – 19.75%;
- oil-based – 19.37%;
- natural gas – 15.95%;
- geothermal – 10.69%;
- wind – 1.58%;
- biomass – 0.73%;
- solar – 0.13%.

2.4 Principal Laws Governing Market Concentration Limits

On 15 September 2014, the ERC issued the 2014 Revised Rules for the Issuance of Certificates of Compliance for Generation Companies, Qualified End-Users and Entities with Self-Generation Facilities (the 2014 Revised COC Rules). Section 1(b)(2) of Article II thereof provides that no company or person may, singly or in combination with others, own, operate or control more than 30% of the installed capacity of a grid and/or 25% of the national installed generating capacity. This limitation does not apply to the self-generation facilities (those constructed, owned and operated by the end-user) located in isolated grids.

For the purposes of calculating a generation company's compliance with the market share limitations, the capacity of such generation facility shall be credited in accordance with ERC Resolution No 26, Series of 2005.

2.5 Agency Conducting Surveillance to Detect Anti-Competitive Behaviour

There are two regulators of anti-competitive behaviour, the ERC and the PCC.

Under the EPIRA (see 1.1 **Principal Law Governing the Ownership and Structure of the Power Industry**, above), the ERC is the agency granted the authority to enforce and promote true market competition, to encourage market development and customer choice, and to monitor, penalise and prevent harmful monopoly, any abuse of market power, anti-competitive or unduly discriminatory action or behaviour by any electric power industry participant.

While the main deterrent to anti-competitive practices is the regulation by the ERC of acquisitions and mergers among corporations engaged in the power sector, the ERC is also given other powers and functions to promote competition and encourage market development. These powers include the authority to monitor agreements entered with price-fixing provisions, to determine and penalise misuse of market power and other unfair trade practices, and to issue orders controlling the price of electricity goods, among other matters.

Under the Competition Rules and Complaint Procedures issued by the ERC, anti-competitive practices include, but are not limited to:

- entering into agreements with provisions that would have, or would be likely to have, the effect of substantially lessening competition, or with provisions on price-fixing;
 - misuse of market power;
 - acquisitions, mergers and consolidations that would have, or would be likely to have, the effect of substantially lessening competition;
 - cross-subsidisation;
 - cartelisation; and
 - other unfair trade practices detrimental to the encouragement and protection of contestable markets.
- Moreover, in determining whether a provision of an agreement, arrangement or understanding, or an acquisition, merger or consolidation, has or is likely to have the effect of substantially lessening competition in a market, the following factors, among others, shall be taken into account:
- the level of concentration in the market;
 - the nature and effect of barriers to entry to the market;
 - the degree of countervailing power in the market;
 - the dynamic characteristics of the market, including growth, innovation and product differentiation;
 - the nature and extent of vertical integration in the market; and
 - the behaviour of competitors in the market.
- The law mandates the ERC to promulgate rules that prohibit anti-competitive behaviour and abuse in the market of power. Pursuant thereto, the ERC has the following powers and functions to preclude or remedy anti-competitive practices:
- grant or withhold clearance for agreements or arrangements, acquisitions, mergers and consolidations, as well as revoke or amend any clearance granted;
 - grant or withhold authorisations to make agreements or arrangements, give effect to an agreement, arrangement or understanding, acquisitions, mergers and consolidations that would or might have the effect of substantially lessening competition in the market, or contain price-fixing provisions, as well as revoke or amend any clearance granted;
 - require documents and information relating to matters that constitute or may constitute anti-competitive practices and compliance with clearance conditions and ERC orders;
 - compel submission of data by market operators according to a monitoring protocol;
 - impose penalties and fines;
 - issue the following orders:
 - (a) cease-and-desist orders;
 - (b) orders requiring the commission of acts to rectify any violation or mitigate the consequences of anti-competitive practices;
 - (c) orders fixing or controlling the price at which violators may supply or acquire electricity or goods or services related to the same;
 - (d) orders revoking or modifying a certificate of public convenience and necessity, licence or permit granted to the violator; and
 - (e) orders requiring violators to dispose of assets or shares in the capital stock of a corporation within such period (not exceeding 12 months from the date of the order) as determined by ERC; and

- investigate matters that may constitute anti-competitive practices.

The ERC is charged with enforcing these restrictions. In this regard, the ERC may impose administrative sanctions without prejudice to the filing of a criminal action, if warranted. For violation or non-compliance with the EPIRA or its IRR, the ERC may impose a fine or penalty from PHP50,000 to PHP50 million. The ERC, along with the DOE, may also recommend to Congress the revocation of the franchise or privilege granted to any party in violation of the EPIRA.

The regular courts may impose a penalty of imprisonment, or a fine ranging from PHP10,000 to PHP10 million, or both, to any person who is found guilty of engaging in anti-competitive behaviour including, but not limited to, cross-subsidisation, price or market manipulation, or other unfair trade practices detrimental to the encouragement and protection of contestable markets, such as engaging in prohibited transactions between electricity utilities and their affiliates mentioned above. The members of the board of directors of juridical entities in violation of the EPIRA may be fined an amount not exceeding double the amount of damages caused by the offender or by imprisonment of one year or two years, or both, at the discretion of the court. This applies to board members of juridical entities who knowingly, or by neglect, allow the commission or omission under the law.

If the offender is a government official or employee, he or she shall, in addition, be dismissed from the government service with prejudice to reinstatement and with perpetual or temporary disqualification from holding any elective or appointive office. If the offender is an alien, he or she may, in addition to the penalties prescribed, be deported without further proceedings after serving any sentence.

The PCC likewise has the original and primary jurisdiction in the enforcement and regulation of all competition-related issues. However, the sector regulators, such as the ERC, shall be consulted and afforded reasonable opportunity to submit its own opinion and recommendation on the matter before the PCC makes a decision on any case. Furthermore, the PCC has the power to intervene and to participate in administrative and regulatory proceedings requiring consideration of the provisions of the Philippine Competition Act (see **1.4 Principal Law Governing the Sale of Power Industry Assets**, above) that are initiated by the ERC. The transmission and distribution sectors are considered as public utilities. However, a favourable or no-objection ruling of the PCC shall not be construed as dispensing of the requirement for a favourable recommendation from the appropriate government agency.

Under the Philippine Competition Act, the PCC has the original and primary jurisdiction in the enforcement and regulation of all competition-related issues. The PCC has the sole and exclusive authority to conduct fact-finding or preliminary inquiry for the enforcement of the Philippine Competition Act. The Regional Trial Court has the original jurisdiction to decide on all criminal and civil cases involving violations of the Philippine Competition Act and other competition-related laws. The sector regulators shall, however, be consulted and afforded reasonable opportunity to submit their own opinion and recommendation on the matter before the PCC makes a decision on any case.

The Philippine Competition Act seeks to level the playing field by prohibiting anti-competitive behaviour. The latter consists of anti-competitive agreements, abuses of dominant positions, and mergers and acquisitions that limit, prevent, and restrict competition. According to the principal author of the Philippine Competition Act, market competition should be promoted in order to provide benefits to consumers through more choices at lower prices. The ultimate objective is to protect consumer welfare, advance domestic and international trade and economic development.

Anti-competitive agreements such as restricting competition as to price, components thereof or other terms of trade as well as fixing price at an auction or in any form of bidding are prohibited. Agreements between or among competitors which have the object or effect of substantially preventing, restricting or lessening competition are likewise prohibited. On the other hand, abuse of dominant position consists of engaging in conduct that would substantially prevent, restrict or lessen competition. This includes selling goods or services below cost with the object of driving competition out of the relevant market, imposing barriers to entry or committing acts that prevent competitors from growing within the market in an anti-competitive manner, making a transaction subject to acceptance by the other parties of other obligations which have no connection with the transactions, and setting prices or other terms and conditions that discriminate unreasonably between customers or sellers of the same goods or services. Lastly, merger or acquisition agreements that substantially prevent, restrict or lessen competition in the relevant market or in the market for goods or services are also prohibited.

Moreover, the PCC, which has original and primary jurisdiction over the enforcement and implementation of the provisions of the Philippine Competition Act, is authorised to:

- conduct an inquiry, investigate, and hear and decide on cases involving any violation of the Philippine Competition Act and other existing competition laws *motu proprio* or upon receipt of a verified complaint from an interested

- party or upon referral by the concerned regulatory agency, and institute the appropriate civil or criminal proceedings;
- review proposed mergers and acquisitions, determine thresholds for notification, determine the requirements and procedures for notification, and upon exercise of its powers to review, prohibit mergers and acquisitions that will substantially prevent, restrict, or lessen competition in the relevant market;
 - monitor and undertake consultation with stakeholders and affected agencies for the purpose of understanding market behaviour;
 - upon finding, based on substantial evidence, that an entity has entered into an anti-competitive agreement or has abused its dominant position after due notice and hearing, stop or redress the same, by applying remedies, such as issuance of injunctions, requirement of divestment, and disgorgement of excess profits under such reasonable parameters that shall be prescribed by the Philippine Competition Act IRR;
 - conduct administrative proceedings, impose sanctions, fines or penalties for any noncompliance with or breach of the Philippine Competition Act and its IRR and punish for contempt;
 - issue subpoena duces tecum and subpoena ad testificandum to require the production of books, records, or other documents or data which relate to any matter relevant to the investigation and personal appearance before the commission, summon witnesses, administer oaths, and issue interim orders such as show-cause orders and cease-and-desist orders after due notice and hearing in accordance with the Philippine Competition Act IRR;
 - upon order of the court, undertake inspections of business premises and other offices, land and vehicles, as used by the entity, where it reasonably suspects that relevant books, tax records, or other documents which relate to any matter relevant to the investigation are kept, in order to prevent the removal, concealment, tampering with, or destruction of the books, records, or other documents;
 - issue adjustment or divestiture orders including orders for corporate reorganisation or divestment in the manner and under such terms and conditions as may be prescribed in the Philippine Competition Act IRR;
 - deputise any and all enforcement agencies of the government or enlist the aid and support of any private institution, corporation, entity or association, in the implementation of its powers and functions;
 - monitor compliance by the person or entities concerned with the cease-and-desist order or consent judgment;
 - issue advisory opinions and guidelines on competition matters for the effective enforcement of the Philippine Competition Act and submit annual and special reports to Congress, including proposed legislation for the regulation of commerce, trade, or industry;
 - monitor and analyse the practice of competition in markets that affect the Philippine economy, implement and oversee

measures to promote transparency and accountability, and ensure that prohibitions and requirements of competition laws are adhered to;

- conduct, publish, and disseminate studies and reports on anti-competitive conduct and agreements to inform and guide the industry and consumers;
- intervene or participate in administrative and regulatory proceedings requiring consideration of the provisions of the Philippine Competition Act that are initiated by government agencies such as the Securities and Exchange Commission, the ERC and the National Telecommunications Commission;
- assist the National Economic and Development Authority, in consultation with relevant agencies and sectors, in the preparation and formulation of a national competition policy;
- act as the official representative of the Philippine government in international competition matters;
- promote capacity building and the sharing of best practices with other competition-related bodies; and
- advocate pro-competitive policies of the government.

The Philippine Competition Act likewise prohibits anti-competitive agreements which have the object or effect of substantially preventing, restricting or lessening competition. Agreements, however, which contribute to improving the production or distribution of goods and services or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits, may not necessarily be deemed a violation of the Philippine Competition Act.

3. Climate Change Laws and Alternative Energy

3.1 Principal Climate Change Laws and/or Policies

The Philippines has enacted two major laws, the Renewable Energy Act of 2008 and the Republic Act No 9729, otherwise known as the Climate Change Act of 2009. The former promotes the use of solar, hydro, geothermal, wind, biomass and ocean energy as sources of electricity in the country to reduce dependence on fossil fuels, while the latter focuses on establishing a framework strategy on climate change and integrating it in all government policies, plans and programmes to address the impacts of climate change.

3.2 Principal Law and/or Policies Relating to the Early Retirement of Carbon-Based Generation

While one of the express policies of the Renewable Energy Act of 2008 is to reduce the Philippines' dependence on fossil fuels, there are no laws or policies providing for the phasing out of coal-fired power generation.

3.3 Principal Law and/or Policies to Encourage the Development of Alternative Energy Sources

The principal law for the development of alternative energy sources is the Renewable Energy Act of 2008 (see **3.1, Principal Climate Change Laws and/or Policies**, above). On 27 July 2012, the ERC approved the initial feed-in tariffs for renewable energy sources, specifically run-of-river hydro, biomass, solar and wind power. On 30 April 2014, the DOE issued a certification to increase the installation target for solar energy generation under the feed-in tariff system from 50 MW to 500 MW. Due to the increased installation target, the ERC approved Resolution No 063, Series of 2015, lowering the feed-in-tariff rate from PHP9.68/kWh to PHP8.69/kWh for operational solar power producers after the first 50 MW have been reached. With respect to wind power, the initial installation target of 200 MW was also increased to 400 MW on 7 April 2015 by the DOE, which was due to a finding that the total capacity of wind power plants built and commissioned during the year 2015 already exceeded the said initial installation target. Thus, the ERC approved Resolution No 14, Series of 2015, lowering the feed-in-tariff rate from PHP8.53/kWh to PHP7.40/kWh and resolved that three wind power projects to a total of 144 MW are entitled to the lower rate. The feed-in tariff for ocean thermal energy conversion resources, however, has been deferred for further study and data gathering.

On 26 February 2016, Republic Act No 10745 became law. It amended the Biofuels Act of 2006 (Republic Act No 9367) by allowing natural gas power generating plants to use neat diesel as an alternative fuel in case of shortage of natural gas supplies.

The Renewable Energy Act of 2008 provides for general incentives for developers of renewable energy, such as:

- an income tax holiday;
- duty-free importation of machinery, equipment and material actually, directly and exclusively used in renewable energy facilities;
- special realty tax rates on equipment and machinery;
- the application of net operating loss carry-over;
- reduced corporate tax rate;
- adoption of accelerated depreciation system for tax purposes;
- 0% value added tax rate;
- cash incentive to renewable energy developers for missionary electrification, i.e., the increase of access to energy for off-grid areas in the Philippines;
- tax exemption of carbon credits;
- tax credit on domestic capital equipment and services; and
- tax rebates and exemption from the universal charge.

Aside from these tax incentives, the Renewable Energy Act of 2008 also mandates the adoption of the feed-in tariff sys-

tem for electricity produced from wind, solar, ocean, run-of-river hydropower and biomass. Such a system ensures a steady return of investment to producers in the form of a fixed tariff to be paid to renewable energy developers on a fixed rate per kilowatt hour for a given period, which should not be less than 12 years. This is pursuant to the Renewable Portfolio Standards policy of the law which requires electric power industry participants to source an agreed portion of their energy supply from eligible renewable energy resources. The Renewable Energy Act of 2008 also establishes a net-metering programme, which refers to a system, appropriate for distributed generation, in which a distribution grid user has a two-way connection to the grid and is only charged for his or her net electricity consumption and is credited for any overall contribution to the electricity grid. It also provides for a green energy option whereby end-users can choose renewable energy resources as their source of energy.

4. Generation

4.1 Principal Laws Governing the Construction and Operation of Generation Facilities

Under Chapter II, Section 6 of the EPIRA, before one may engage in the generation of electricity as a new generation company, one must obtain a certificate of compliance (COC) from the ERC before commencing commercial operation of facilities for the production of electricity (generation facilities).

4.2 Regulatory Process for Obtaining All Approvals to Construct and Operate Generation Facilities

Under Chapter III of the 2014 Revised COC Rules, all entities operating generation facilities or facilities for the production of electricity shall apply for a COC with the ERC. To secure a COC, a new generation company must submit documentary evidence that it is authorised to conduct business in the Philippines. Thus, it must be registered as such with the Securities and Exchange Commission. Likewise, as prerequisites for the issuance of a COC, an Environmental Compliance Certificate (ECC) from the Department of Environment and Natural Resources (DENR) and a DOE endorsement indicating that the power plant of the applicant is consistent with the Power Development Programme of the national government must also be secured.

The ECC mentioned in the preceding paragraph is a permit issued by DENR after a positive review of the project's application. This certificate indicates that the proposed project or undertaking will not cause a significantly negative impact on the Philippine environment. The ECC contains specific measures and conditions that must be met by the project proponent before and during the operation of the project. In some cases, conditions are listed to be performed during the

project's abandonment phase to lessen identified potential environmental impacts.

An ECC also certifies that the proponent has complied with all the requirements of the Environmental Impact Statement (EIS) System and has committed to implement its approved environmental management plan. The general requirements for an ECC include: a letter of request to DENR-EMB stating a desire to apply for the ECC; a project description, indicating raw materials to be used and the process or technology to be implemented; an estimated project capacity, type and volume of the products and discharges; proof of possession of the necessary capital for a proposed project; location map of the project area, and manpower requirements.

The application for an ECC also includes the conduct of an Environmental Impact Assessment which evaluates and predicts the likely impact of a project during construction, commissioning, operation and abandonment stages of a project. It also includes the designing of the appropriate mitigating and preventing measures to address any environmental consequences of a project. While formal or adversarial hearings are not required, public input is solicited usually through the form of public hearings with notice to affected stakeholders and communities.

Furthermore, depending on the local government unit where the generation facility will be constructed, there are licences that may be required from the local government having jurisdiction over the area where the generation facility will be constructed. Finally, depending on whether the generation facility is located within the ancestral domain of indigenous cultural communities or indigenous peoples, a certification precondition or certificate of non-overlap as issued by the National Commission on Indigenous Peoples may be required.

If all the requirements are complied with, including the technical inspection of the facilities, the ERC shall notify the concerned party of its action within 60 calendar days from the conduct of the technical inspection. In the event that the ERC requires the submission of additional information or documents or orders the postponement of final action on the application on reasonable grounds, the 60-day period shall be reckoned from the date of complete submission of the additional required information or the lifting of the suspension of the final action on the application. Failure to comply with any of the requirements, documents or information within the period granted by the ERC shall be grounds for the denial thereof without prejudice to the re-filing of the application. No party may engage in the commercial generation of electricity unless it has complied with the technical, financial and environmental standards as provided in the COC.

A generation company operating a renewable energy plant eligible to access the feed-in-tariff system shall indicate in its COC application its intention to operate under the feed-in-tariff system. This generation company shall be allowed to operate and be entitled to payment of the feed-in-tariff only upon the issuance of a COC explicitly indicating feed-in-tariff eligibility (FIT-eligible COC). A FIT-eligible COC may only be issued upon the issuance of the appropriate certificate of endorsement for feed-in-tariff eligibility by the DOE.

Pending the approval of the COC application, no generation company shall operate its generation facility unless a provisional authority to operate (PAO) is issued by the ERC. The PAO shall be issued in the form of a notification to the applicant and shall be valid for a period of six months from issuance thereof. The six-month validity period shall be included in the five-year term of the COC that may be issued by the ERC for such generation facilities.

4.3 Terms and Conditions Imposed in Approvals to Construct and Operate Generation Facilities

A generation facility is required to comply with the technical, financial and environmental standards specified in Rule 5, Section 4 of the Rules and Regulations to Implement the EPIRA (EPIRA IRR). It is likewise required to comply with, among other regulations, the following provisions of the EPIRA IRR:

- Rule 9, Section 4, on membership criteria in the WESM;
- Rule 11 on cross-ownership, market abuse and anti-competitive behaviour; and
- Rule 29 on benefits to host communities.

A COC issued in favour of the owner or operator of the generation facilities shall include all the generation units situated in one contiguous area, which are in operation at the time of issuance. For modular generating facilities located in a contiguous area, one COC shall be issued for each generating unit. Further, only a single COC shall be issued in favour of a generation company owning a power barge even if it consists of several generating units. However, for generation facilities consisting of several generating units that are installed and commissioned on different dates within a span of 24 months, individual COCs shall in the meantime be issued for each generating unit. A consolidated COC shall then be issued after inspection of the last generating unit of the generation facility.

4.4 Proponent's Eminent Domain, Condemnation or Expropriation Rights

In the Philippine jurisdiction, eminent domain is defined as the power of the nation or a sovereign state to take, or to authorise the taking of, private property for a public use

without the owner's consent, conditioned upon payment of just compensation (Barangay Sindalan, et al v Court of Appeals, et al, G.R. No 150640, 22 March 2007). The exercise of the power of eminent domain is constrained by two Philippine constitutional provisions: (i) that private property shall not be taken for public use without just compensation under Article III (Bill of Rights), Section 9, and (ii) that no person shall be deprived of his/her life, liberty, or property without due process of law under Article III, Section 1.

Thus, only state-owned generators can exercise the power of eminent domain or expropriation.

Expropriation is a two-pronged proceeding: first, the determination by a court of competent jurisdiction of the authority of the plaintiff to exercise the power and the propriety of its exercise in the context of the facts; and second, in the event of an affirmation of the expropriation, the determination of just compensation for the property being expropriated. Under Rule 67 of the Philippines' Rules of Court, court, commissioners shall determine the just compensation to be paid.

Just compensation has been held as the fair value of the property as between one who receives, and one who desires to sell, fixed at the time of the actual taking by the government. This rule holds true when the property is taken before the filing of an expropriation suit, and even if it is the property owner who brings the action for compensation. The nature and character of the land at the time of its taking is the principal criterion for determining how much just compensation should be given to the landowner. In determining just compensation, all the facts as to the condition of the property and its surroundings, its improvements and capabilities, should be considered (NPC v Dr Antero Bongbong, et al, G.R. No 164079, 3 April 2007).

4.5 Requirements for Decommissioning

Under Section 10(c) of the 2014 Revised COC Rules, a generation facility must submit a written disclosure within three days of any event which results in a material change concerning or potentially affecting its management, operation or financial condition. The ERC has interpreted the foregoing provision to apply to the decommissioning of generation facilities. Other than this, the generation facility must still carry out any mitigating measures provided in its ECC.

5. Transmission

5.1 Regulation of Construction and Operation of Transmission Lines and Associated Facilities

5.1.1 Principal Laws Governing the Construction and Operation

No person or entity other than the NGCP is authorized to construct or operate transmission networks in the Philippines. The exclusive right to operate, manage and maintain, including the right to construct, install, finance, manage, improve, expand, operate, maintain, rehabilitate, repair and refurbish the present nationwide transmission system of the Philippines was granted to the NGCP by virtue of a legislative franchise. The same franchise prohibits the transfer or lease of the right to construct or operate the Philippine transmission system to any other person or entity; see the Republic Act No 9511.

5.1.2 Regulatory Process for Obtaining All Approvals to Construct and Operate Transmission Facilities

See **5.1.1 Principal Laws Governing the Construction and Operation**, above.

5.1.3 Terms and Conditions Imposed in Approvals to Construct and Operate Transmission Facilities

See **5.1.1 Principal Laws Governing the Construction and Operation**, above.

5.1.4 Proponent's Eminent Domain, Condemnation or Expropriation Rights

Under Section 4 of Republic Act No. 9511, the NGCP is granted the authority to exercise the right of eminent domain; see **4.4 Proponent's Domain, Condemnation or Expropriation Rights**, above, for the discussion as to how it may be exercised in the Philippine context.

5.1.5 Transmission Service Monopoly Rights

See **5.1.1 Principal Laws Governing the Construction and Regulation**, above.

5.2 Regulation of Transmission Service, Charges and Terms of Service

5.2.1 Principal Laws Governing the Provision of Transmission Service, Regulation of Transmission Charges and Terms of Service

The Philippine Grid Code (PGC) issued by the ERC, establishes and documents the basic rules, requirements, procedures and standards that govern the operation, maintenance and development of the high-voltage backbone transmission system in the Philippines. It identifies the obligations of three key independent functional groups: the grid owner, system operator, and market operator. These functional groups and all users of the grid must comply with all the provisions of the PGC. The PGC is intended to be used along with the

market rules of the WESM to ensure the safe, reliable and efficient operation of the grid.

The PGC specifies, among other matters, the minimum technical, design and operational criteria and the procedures to be complied with by any person or entity that uses the grid and its related facilities, who is connected or seeking connection to the grid, and the minimum technical, design and operational criteria of the grid owner at the connection site with users. It also presents a unified listing of all the data required by the system operator from users and by users from the grid owner.

The PGC also established a Grid Management Committee (GMC), which is the mechanism through which the industry participants and end-users may participate in the decision and policy-making as regards the operation, maintenance and development of the grid.

Meanwhile, other responsibilities of the Transmission Provider and the functions of the System Operator are found in the Revised Rules, Terms and Conditions for the provision of Open Access Transmission Service (OATS Rules). The OATS Rules are based on the EPIRA IRR, the PGC, and the WESM Rules.

5.2.2 Establishment of Transmission Charges and Terms of Service

The ERC determines power transmission rates. It regulates the NGCP, the sole transmission service provider, under performance-based rate-making (PBR), a form of utility regulation that strengthens the financial incentives to lower rates or lower costs. The ERC can use revenue cap, price cap or hybrid cap. The PBR methodology is outlined in the Rules for Setting Transmission Wheeling Rates.

All final orders, resolutions or decisions of the ERC may be subjected to a motion for reconsideration by an affected part pursuant to Rule 23 of the ERC's Rules of Practice and Procedure.

All actions and decisions rendered by the ERC are subject to review. In particular, the decisions or orders of the ERC may be appealed to the Office of the President, and thereafter brought before the Court of Appeals by filing a verified petition for review under Rule 43 of the Rules of Court on the ground of errors in judgment. If the Court of Appeals renders an unfavourable decision, such decision may be appealed to the Supreme Court via a petition for review on certiorari.

However, under Section 46 of the EPIRA, cases decided by the ERC involving questions of fact are directly appealable to the Court of Appeals under Rule 43 of the Rules of Court.

Decisions by the ERC involving questions of law may be directly appealed to the Supreme Court via a petition for review on certiorari.

5.2.3 Open Access Transmission Service

The NGCP, as the system operator of the nationwide electrical transmission and sub-transmission system, must provide open and non-discriminatory access to its system to all electricity users and ensure and maintain the reliability, adequacy, security, stability and integrity of the grid in accordance with the standards set in the PGC and the Distribution Code.

Any user seeking connection to the grid is eligible, provided they comply with the requirements. The PGC states that a new connection to the grid requires a connection agreement with the grid owner, TRANSCO, prior to actual connection to the grid. The connection agreement functions to establish the asset boundary, define the responsibilities at the asset boundary, contain the provision on applicable charges, and allow the transmission customer to remain connected in order to continually avail themselves of the services. The new user also needs to secure from the grid owner a five-year statement of the Transmission Development Plan (TDP). Moreover, the OATS Rules provides for the responsibilities accepted by transmission customers as a condition of receiving transmission service.

6. Distribution

6.1 Regulation of Construction and Operation of Electric Distribution Facilities

6.1.1 Principal Laws Governing the Construction and Operation of Electric Distribution Facilities

The distribution of electricity to end-users is a regulated common carrier business requiring a national franchise. Distribution of electric power to all end-users may be undertaken by private distribution utilities, electric co-operatives, local government units presently undertaking this function, and other duly authorised entities, subject to regulation by the ERC. The power to grant franchises to persons engaged in the transmission and distribution of electricity is vested exclusively in the Congress of the Philippines. A Certificate of Public Convenience and Necessity is subsequently issued by the ERC.

To construct a distribution network, the distribution utility will have to apply for approval with the ERC and secure the necessary permits from the appropriate local government units, the ECC from the DENR and the permit by the Department of Public Works and Highways for the excavation or roadworks on national highways. Electric co-operatives

are electric distribution utilities organised either as non-stock, non-profit co-operatives, or stock co-operatives. The former is governed by the National Electrification Administration Decree (Presidential Decree No 269, Series of 1973, as amended), and the latter by the Philippine Co-operative Code (Republic Act No 6938, as amended). Regardless of type, the National Electrification Administration (NEA) shall have the authority of the electric co-operatives to require submission of reportorial requirements as may be necessary relative to their operations as electric distribution utilities.

6.1.2 Regulatory Process for Obtaining All Approvals to Construct and Operate Distribution Facilities

Under the EPIRA), distribution utilities and electric co-operatives (as distribution utilities), retail electricity supplier (RES), and entities participating in the WESM may engage in the sale of power to customers.

Generally, all suppliers of electricity to the contestable market have to acquire a RES licence from the ERC, except for distribution utilities and electric co-operatives with franchises from the Congress of the Philippines with respect to their existing franchise areas. The following may obtain a RES licence to become a supplier:

- generation companies or affiliates thereof;
- affiliates of distribution utilities with respect to the latter's contestable market within or outside its franchise area, subject to restrictions imposed by the ERC on market share limits and the conduct of business activities;
- retail aggregators;
- IPP administrators; and
- any other person authorised by the ERC to engage in the selling, brokering or marketing of electricity to the contestable market.

Furthermore, electricity suppliers participating in the WESM are required to register with the WESM Market Operator in order to be able to inject or withdraw electricity from the grid. This is accomplished by the approval of an application for registration accompanied by payment of the registration fee.

6.1.3 Terms and Conditions Imposed in Approvals to Construct and Operate

See **6.1.1 Principal Laws Governing the Construction and Operation of Electric Distribution Facilities** and **6.1.2 Regulatory Process for Obtaining All Approvals to Construct and Operate Electric Distribution Facilities**, above.

6.1.4 Proponent's Eminent Domain, Condemnation or Expropriation Rights

See **4.4 Proponent's Domain, Condemnation and Expropriation Rights**, above.

6.1.5 Distribution Service Monopoly Rights

Electric distribution entities cannot have an exclusive right to construct/operate distribution facilities within a defined territory, as this may constitute anti-competitive behaviour. As discussed above in **2.5 Agency Conducting Surveillance to Detect Anti-competitive Behaviour**, the ERC must enforce and promote true market competition and monitor, penalise and prevent harmful monopoly, any abuse of market power, anti-competitive or unduly discriminatory action or behaviour by any electric power industry participant.

6.2 Regulation of Distribution Service, Charges and Terms of Service

6.2.1 Principal Laws Governing the Provision of Distribution Service, Regulation of Distribution Charges and Terms of Service

The EPIRA (see **1.1 Principal Law Governing the Ownership and Structure of the Power Industry**, above) and the Philippine Distribution Code are the applicable laws. The Philippine Distribution Code establishes the basic rules and procedures that govern the operation, maintenance, development, connection and use of the electric distribution systems in the Philippines. Compliance therewith is mandatory for all participants in the electrical distribution system.

6.2.2 Establishment of Distribution Charges and Terms of Service

The ERC determines distribution service rates. Every distribution utility is strictly governed in its charges by the schedule of rates prescribed by the ERC and cannot change without the ERC's prior approval. This determination of retail rates charged by distribution utilities is made under the principle of full recovery. Under full recovery, distribution utilities subdivide their retail rate into two distinct categories, namely pass-through charges and wheeling charges.

Pass-through charge follows the principle of full economic recovery where a distribution utility may pass on all the charges it incurred in the distribution of power – the price of the power, transmission charge, systems loss charge, etc – to its customers.

The wheeling charge is the cost or charge regulated by the ERC for the use of a distribution system and the utilisation of related services. The Rules for Setting Distribution Wheeling Rates established a price cap for each regulated entity to allow them to recover efficient expenditures only and provide an appropriate return to investors in the regulated

distribution systems. In addition, built-in incentives exist to further improve the efficiency of operating and capital expenditures, as well as network and service performance levels that are expected to result in lower electricity rates in the long term. The price cap is computed by considering several factors, such as: the previous year's price per unit of electricity, the performance incentive factor, the index of change in consumer prices, the correction for revenue over or under recovery in the previous year, the efficiency factor (which imputes efficiencies in both operating and capital expenses), and the correction for taxes over or under recovery in the previous year.

Rates are determined in rate cases filed before the ERC and subject to public hearing as provided in the ERC Rules of Practice and Procedure (see **1.4 Principal Law Governing the Sale of Power Industry Assets**, above). For purposes of challenging any final orders of the ERC, see **5.2.2 Establishment of Transmission Charges and Terms of Service**, above.

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