The Market Testing of Power Supply Agreements: Rationale and Design Evolution in the Philippines

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By

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Abstract

We first set out the rationale for the emerging policy of the Competitive Selection Process (CSP) which mandates market testing the Power Supply Agreements (PSA) of Distribution Utilities in the Philippines. It will potentially address several possible market failures such as connected dealings ("sweetheart deals," in common parlance) with proprietary GENCOS, lack of incentives for DUs to procure at lowest cost, abuse of market power by large GENCOS in certain localities, etc. It will also potentially lighten the regulatory load of the Energy Regulatory Council (ERC) by replacing the burdensome and politically-sensitive accounting method of evaluating PSAs. It may also attract additional generation capacities by new players. Lower generation cost—and finally, lower prices for consumers—is also a possibility, but not guaranteed. We then discuss the evolution of the design of the CSP over the last two years and how the simplest and best modality was finally arrived at.

Keywords: competitive selection, power supply contracts, market failures, outsourcing to market

JEL Code: K2, K23

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Part 1
Introduction: Need and Rationale

The market testing of power supply agreements—labelled the Competitive Selection Process (CSP)—was first proposed for all Distribution Utilities (DUs) in 2013 in an Energy Regulatory Council (ERC) resolution mandating it for DUs' Power Supply Agreements (PSA). This resolution, however, remained unsigned and likely sidelined in deference to the initiatives along similar lines pursued by the Department of Energy (DOE). CSP was the subject of DOE Circular No. DC2015-06-0008 (DC 06-0008 from hereon) signed 11 June 2015 entitled: *"Mandating All Distribution Utilities to Undergo Competitive Selection Process (CSP) in Securing PSA."* This Circular was eventually superseded by *Joint Resolution 1* promulgated by both the ERC and the DOE on 20 October 2015.

PSAs are contracts for the delivery of power by GENCOS to DUs specifying the quantity, price, delivery dates and other terms, many of them contingent on other events, such as the exchange rate movement. The PSAs of a DU with one or several GENCOS generate the generation cost of the DU which is submitted and subject to approval by the regulatory office, the ERC. If approved by the ERC, the generation cost is passed on to consumers of the said DU. Generation cost constitutes an average of 48% of the total charge per kilowatt to the consumer. An example of the power purchase profile and generation cost breakdown is that of Manila Electric Company (Meralco) for April 2015 **(Figure 1)**.

The principal features of the DC 06-0008 were:

1. All PSA contracts covering uncontracted demand must be subject to Auction.
2. The mandatory aggregation and auction of un-contracted demand of small DUs.
3. Mandatory Participation of DUs in the auction program but optional participation for GENCOS.
4. One PSA contract template for the auctions; and one transactions manager.

The Enabling Law: EPIRA (2001)

The enabling law supporting the DOE DC2015-06-0008 is EPIRA (2001). EPIRA (Electric Power Industry Reform Act of 2001) was the state response to numerous problems confronting the state-dominated power sector. One of these problems was the fiscal drain attributed to the state-owned and operated GENCOS and state-owned Transmission Grid. The fiscal drain in turn was due in large part to *take-or-pay contracts* with independent power producers (IPP) which feature was outlawed under EPIRA and high power prices. For example, NPC debt was 28% of GDP in 2003. EPIRA sought to completely open the power sector to market players, e.g., privatization of NPC assets, retail competition (RCOA), and spot market for power (Wholesale Electricity Spot Market). The power industry structure envisioned in EPIRA is "partially unbundled": generation, distribution, and transmission were unbundled with the exception that GENCOS are allowed to procure up to 50% of their power demand from affiliated/proprietary GENCOS. EPIRA considers power distribution and power transmission as regulated activities but generation as competitive. Distribution utilities will be regulated as long as it has captive consumers, meaning, that retail competition remains incomplete. **Figure 2** gives the power industry structure consequent to EPIRA.

Figure 1: Power Purchase profile of Meralco for March 2015

COMPUTATION OF THE GENERATION CHARGE FOR MARCH 2015[a]
(Applicable for Customers Not Under Meralco TOU)
Based on February 2015 Generation Costs

Source		(A) GWH (million kWh) Purchased)	(B) Energy Share (%)	(C) Basic Generation Cost (PhP million)	(D) Other Cost Adjustments[b] (PhP million)	(E = C + D) Total Gen Cost for the Month (PhP million)	(F = E/A) Average Gen Cost (Feb 2015) (PhP/kWh)	(G) Average Gen Cost (Jan 2015) (PhP/kWh)	(H = F - G) Incr/(Decr) (PhP/kWh)
A. Power Supply Agreements (PSAs)	Dispatch[c]								
1. SEM-Calaca Power Corp. (SCPC)	99.6%	185.29	8.0%	592.58	1.17	593.75	3.2044	3.4770	(0.2726)
2. Masinloc Power Partners Corp. (MPPC)	97.5%	166.90	7.2%	780.65	(0.79)	779.86	4.6726	4.8394	(0.1668)
3. Therma Luzon Inc. (TLI)	78.6%	146.15	6.3%	550.60	1.10	551.71	3.7750	4.1332	(0.3582)
4. San Miguel Energy Corp. (SMEC)	83.3%	204.40	8.8%	842.78	2.58	835.35	4.0869	4.6222	(0.5353)
5. South Premiere Power Corp. (SPPC)	65.7%	520.37	22.4%	2,262.88	4.31	2,267.19	4.3569	4.5528	(0.1959)
6. Therma Mobile Inc. (TMO)	20.6%	30.67	1.3%	295.53	(0.15)	295.38	9.6295	15.4217	(5.7922)
Subtotal	72.5%	1,253.78	53.9%	5,315.03	8.21	5,323.24	4.2457	4.5442	(0.2985)
B. Power Purchase Agreements (PPAs/IPPs)									
1. Quezon Power Phils Ltd. Co. (QPPL)[d]		(2.06)	-0.1%	638.54	7.91	646.45		6.5590	
2. First Gas Power Corp. (FGPC) - Sta. Rita	83.9%	644.80	27.7%	3,013.44	19.77	3,033.22	4.7041	5.0470	(0.3429)
3. FGP Corporation (FGP) - San Lorenzo	73.5%	298.85	12.9%	1,447.66	7.57	1,455.23	4.8695	4.9960	(0.1265)
Subtotal	62.1%	941.59	40.5%	5,099.64	35.25	5,134.89	5.4535	5.2780	0.1755
C. Wholesale Electricity Spot Market (WESM)		103.94	4.5%	726.27	307.78	1,034.04	9.9488	8.8106	1.1382
D. Others[e]		24.81	1.1%	248.27	(0.01)	248.26	10.0060	9.0297	0.9763
Total Generation Cost for Captive		**2,324.12**	**100.0%**	**11,389.21**	**351.22**	**11,740.43**	**5.0516**	**5.0677**	**(0.0161)**
Generation Rate Adjustments									
Pilferage Recovery							(0.0135)[f]	(0.0154)	0.0019
Compensation for Deloaded kWhs of ILP Participants[g]							0.0000	0.0004	(0.0004)
High Load Factor Rider							0.0008	0.0003	0.0005
TOU Differential[h]							0.0130	0.0139	(0.0009)
NPC Gram							0.1578	0.1715	(0.0137)
Generation Charge for Billing						***billing month***	**5.2097** ***Mar 2015***	**5.2384** ***Feb 2015***	**(0.0287)**

Notes:

[a] Based on February 2015 month's preliminary bills of PSAs and Wholesale Electricity Spot Market (WESM), and final bills for the rest of the suppliers

[b] Pertains to Forex Differentials for PSAs (TLI, SMEC, and SPPC) and IPPs (QPPL, Sta. Rita, San Lorenzo) and previous months' adjustments for WESM, SCPC, MMPC, Therma Mobile and 1590 Energy Corp.

[c] The dispatch figures shown are a) the load factors of the PSA plants in relation to their actual supply for the month and, b) the plant capacity factors (PCF) of the IPPs

[d] Under scheduled maintainance for the whole supply period

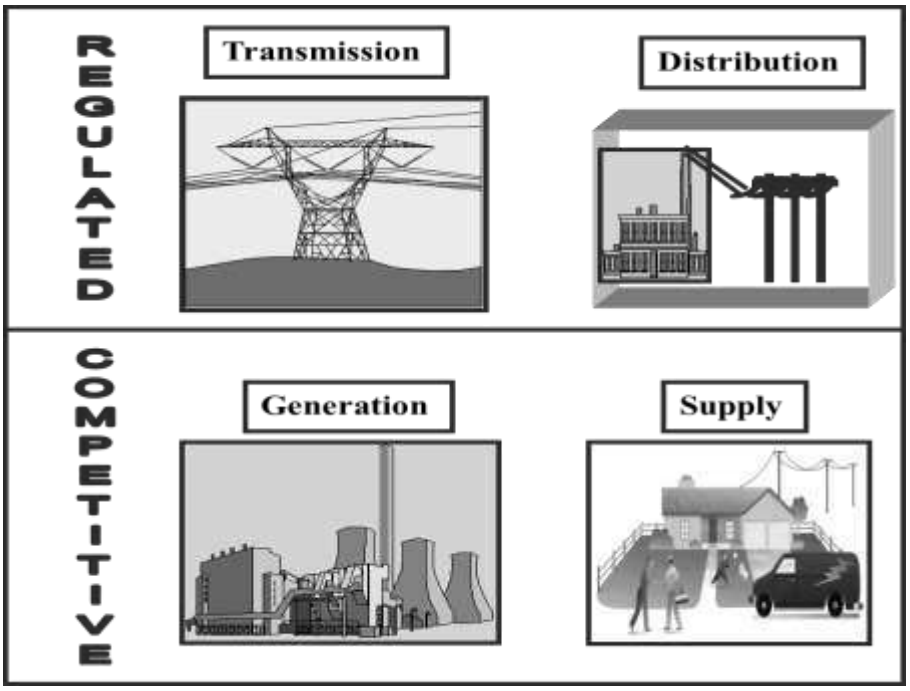
[e] Includes Renewable Energy (Philpodeco, Bacavelley Energy Inc., Pangea Green Energy Philippines and export energy from Net Metering customers) and 1590 Energy corp.

[f] Represents the amount of PhP31.3 million pilferage recovery returned by Meralco to its customers

[g] In accordance with ERC Order dated April 11, 2014 on Meralco's Interruptible Load Program (ILP) implementation

[h] Calculated based on the formula approved by the ERC in its decision under ERC Case No. 2012-117 RC

Figure 2: Power Industry Profile Post EPIRA and Classification



Source: ERC

The following EPIRA provision (Section 2.c) shows that the CSP conforms with the spirit of the Act:

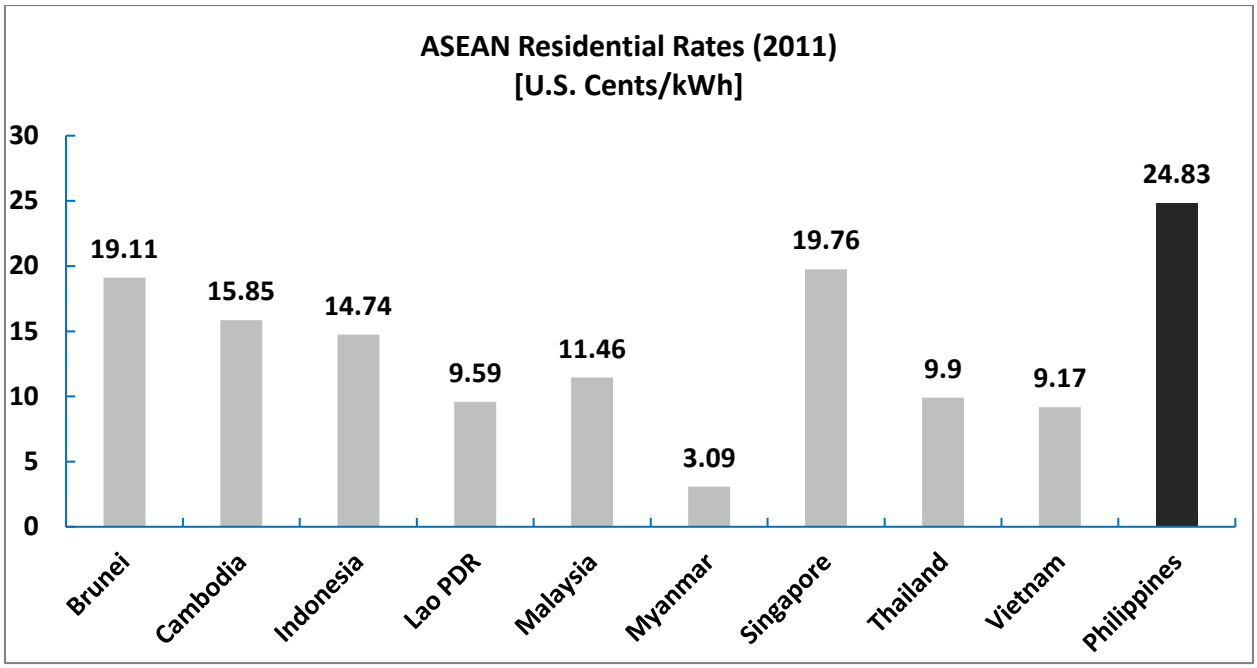
> Sec 2c: *"To ensure transparent and reasonable prices of electricity in a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency and enhance the competitiveness of Philippine products in the global market."*

The main purpose of the CSP is to mandate market competition in power procurement of DUs as long as these have captive consumers. CSP may be viewed as an interim policy while the roll-out of RCOA remains incomplete. To date, that is by February 2016, retail competition has been limited to 750-megawatt consumers. In other jurisdictions where all consumers have become contestable (complete RCOA) as in New Zealand, CSP of PSAs has ceased. This is because it is understood that full retail competition will force DUs to procure from lowest cost supplier or lose contestable retail customers. To date, the Meralco franchise has lost about one gigawatt of its captured market to contestable status.

Power Prices in the Philippines

The Philippines' electricity prices have now become the highest in Asia apart from Japan. **Figure 3** gives the residential rates across the region (2011).

Figure 3: Cross Residential Rates

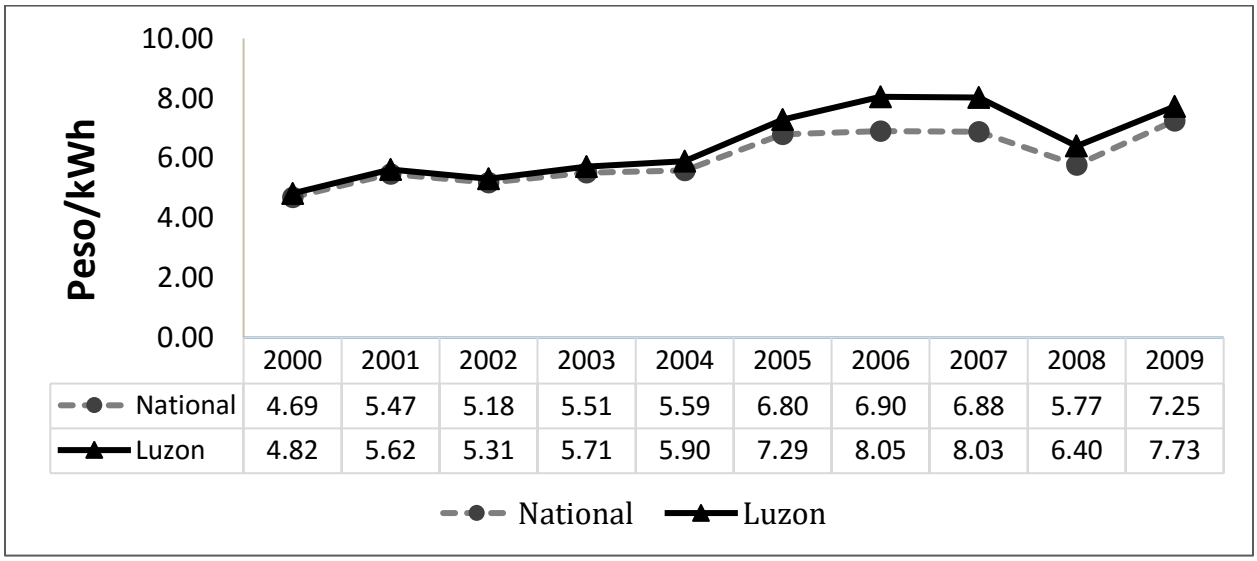


Source: JICA-IEEJ (2013)

Power Price Trajectory in the EPIRA Era

Despite EPIRA—and some will say because of it—the price of power in the Philippines continues to rise.

Figure 4: Trajectory of the Post-EPIRA Price of Power: Luzon and National



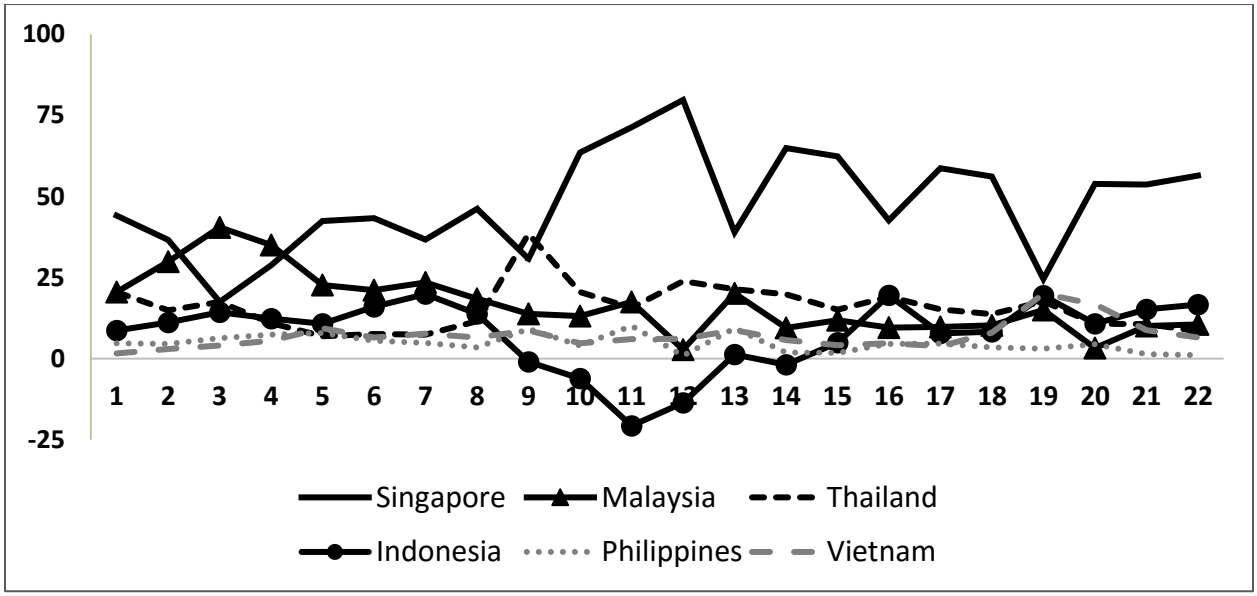
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
National	4.69	5.47	5.18	5.51	5.59	6.80	6.90	6.88	5.77	7.25
Luzon	4.82	5.62	5.31	5.71	5.90	7.29	8.05	8.03	6.40	7.73

Source: EPIRA Implementation Reports, DOE [2007 is an estimate]

Needless to say, this high power cost erodes the competitiveness of power-intensive tradeable sectors, especially of Manufacturing; reduces the capacity of the country to attract foreign investment, especially in the traded goods sector; and discourages investment in general.

The Philippines has the lowest investment rate in the region (21%) and the lowest share in DFI in the region. **Figure 5** gives the share of the Philippines (dark red) in the net DFI into the ASEAN.

Figure 5: Philippine Share in DFI to the ASEAN



Source of original data: UNCTAD

The twin goals of poverty reduction and employment creation of the government are jeopardized. The CSP is envisioned to result in a more market-determined and transparent generation cost of power and reduced administrative burden for the regulators.

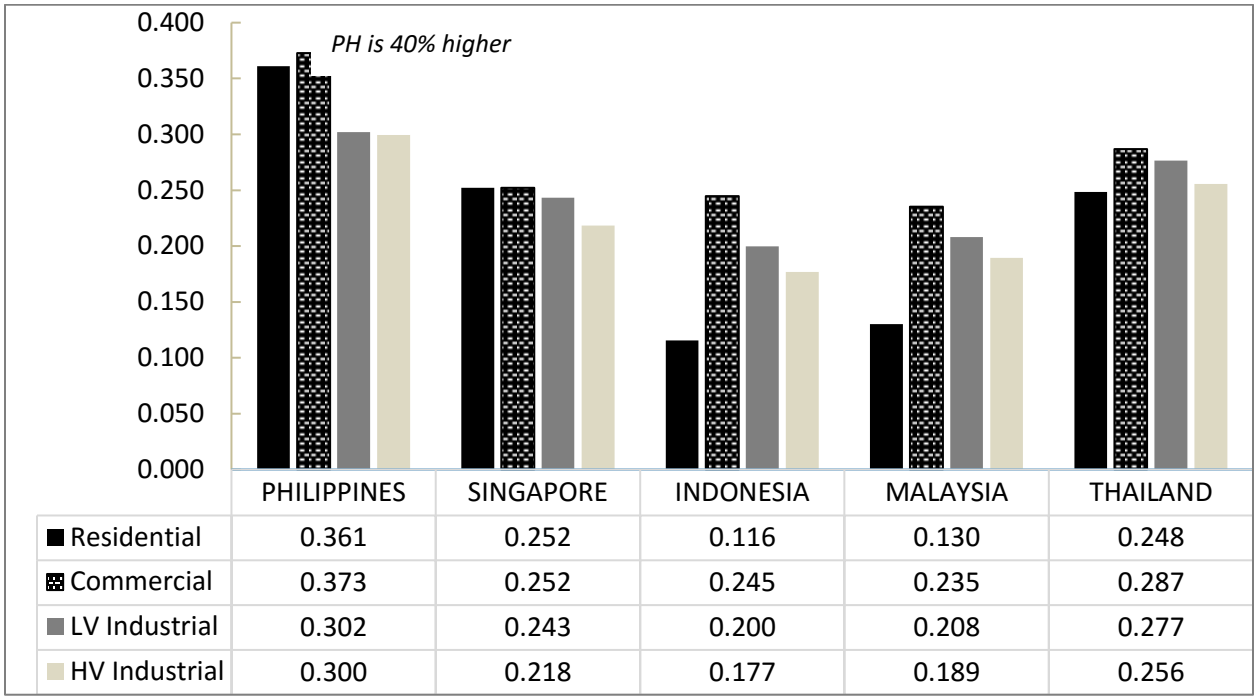
Possible Reasons for High Power Cost

Apart from the archipelagic geography which clearly contributes to higher cost, there are many other possible reasons for the high cost of electricity in the Philippines.

1. Taxes and Subsidies

   The role of "Taxes and Subsidies" in the high power cost is a debated issue. R. del Mundo (2014) claims that based on USAID 2013 data, taking out the taxes and subsidies from power tariffs in the Philippines does not change the position of the country in the comparative tariff table. **Figure 6** reproduces his figure.

Figure 6: Comparative Tariff Rates by Country with Philippine Taxes and Subsidies Removed



	PHILIPPINES	SINGAPORE	INDONESIA	MALAYSIA	THAILAND
Residential	0.361	0.252	0.116	0.130	0.248
Commercial	0.373	0.252	0.245	0.235	0.287
LV Industrial	0.302	0.243	0.200	0.208	0.277
HV Industrial	0.300	0.218	0.177	0.189	0.256

Source: USAID (2013) cited in Rowaldo del Mundo (2014)

Others claim that subsidies, especially in Indonesia, are crucial.

2. Low Generation Capacity per Capita

The Philippines has the lowest per capita generation capacity at 725kwh, which is only a third of Thailand's at 2328 kwh (**Table 1**).

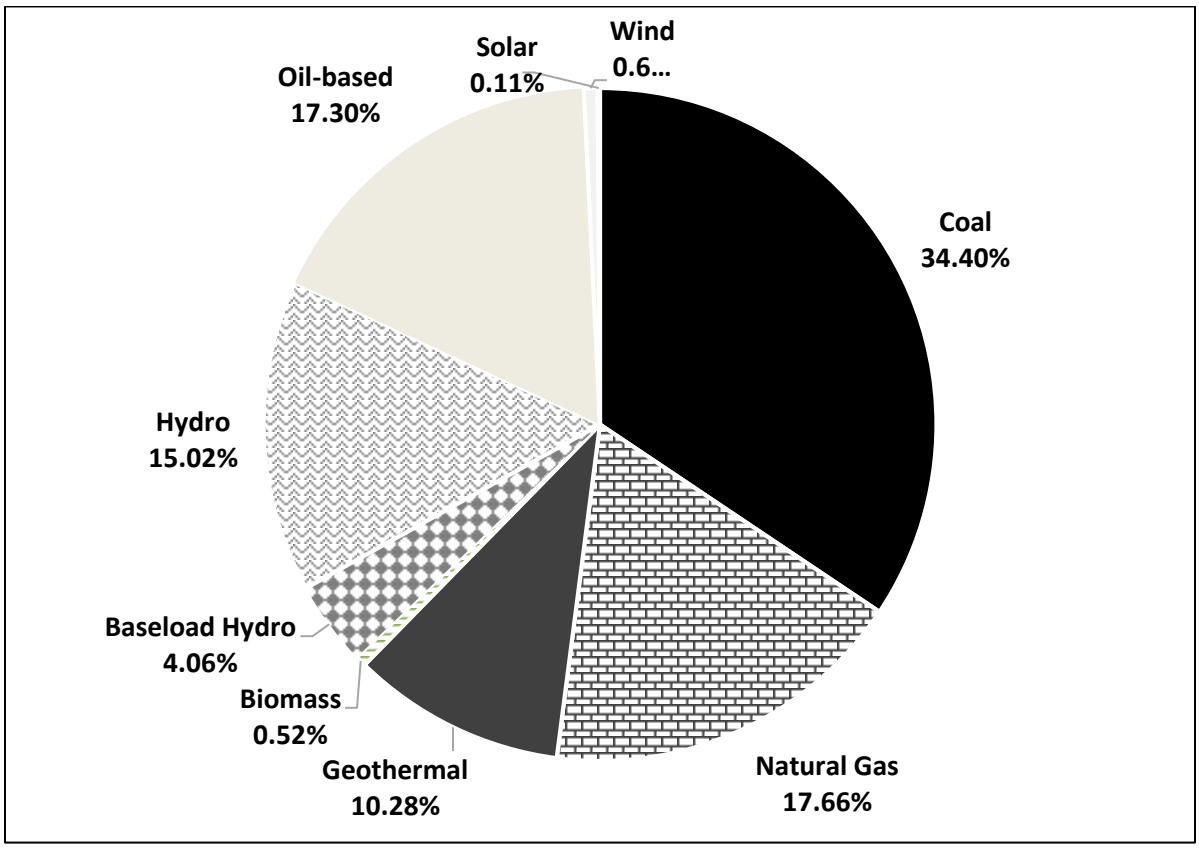
Table 1: Per Capita Generation Capacity in 5 + 3

Country	Per Capita Net Generation Capacity in kWh (2012)
Philippines	725.60
Thailand	2,328.27
Indonesia	747.20
Malaysia	4,369.63
Vietnam	1,307.92
China	3,518.05
Japan	7,601.28
Korea	10,072.32

3. Very Low Power Reserves due to the Dearth of New Greenfield Investment in the EPIRA Era
4. Fuel Mix

Figure 7 below shows the distribution of power source by fuel. Coal-based power—constituting 34.40% of total in 2014—is the cheapest, so an increase in the share of coal-based power, say to 50%, will favorably impact the generation cost considerably. This path is limited due to the existence of long-term bilateral contracts involving higher cost fuels such as natural gas binding on DUs, say, on Meralco.

Figure 6: Power Mix in the Philippines in 2014



Source: DOE

One cannot fail to note that the share of renewable energy in the Philippine energy mix was at 30.65% in 2014. This is so much higher than renewable shares in the Asian region and in the world. The Philippine power sector is one of the most renewables-intensive in the world. This should form an important point of departure for the choice of energy mix and planning for the future. The Philippines is a victim of global warming for which other countries, not the Philippines, are responsible.

5. Cost of Financing, Stranded Asset, FIT and Universal and Missionary Activities charged to power consumers instead of the Philippine treasury.

6. Government Failures

Red tape, licensing requirements, *local-national impasses* leading to long delays and the dearth of investment in greenfield plants. **Box 1** of long delay due to local hurdles is the case of the Redondo Coal Power Project in Subic which has been delayed despite having previously passed all the national legal and environmental requirements.

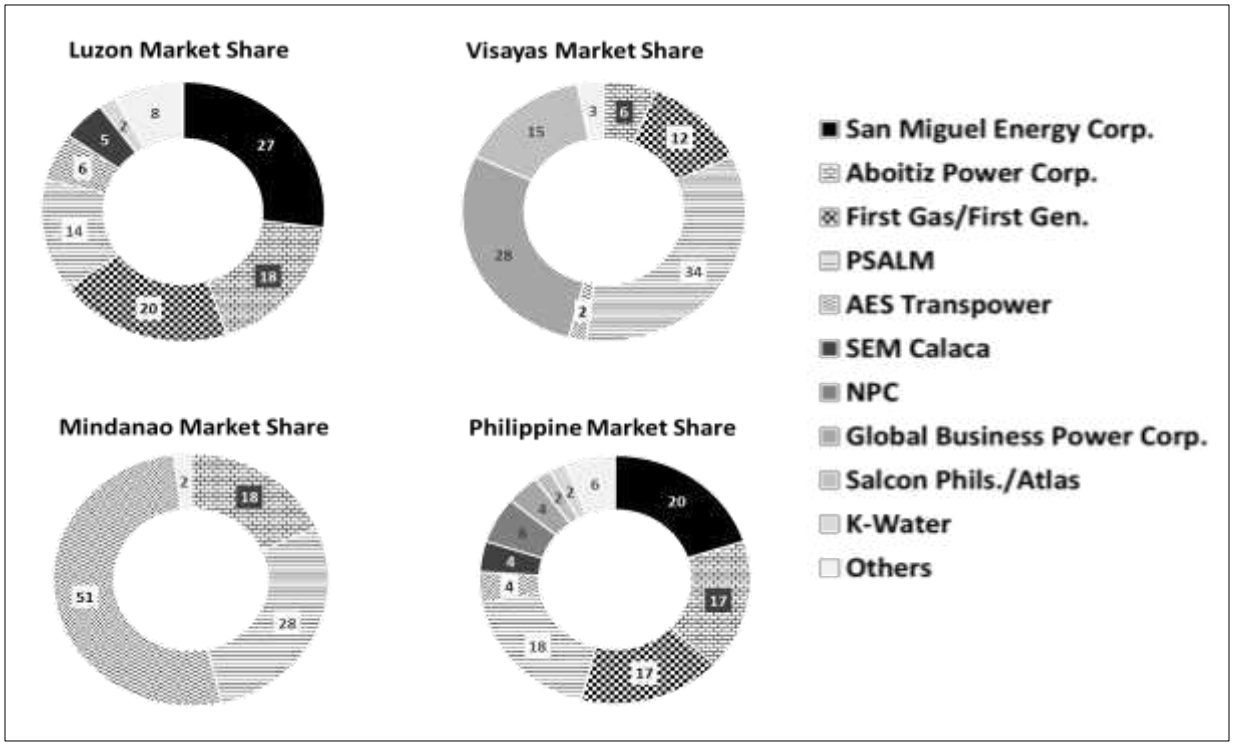
Box 1: The Redondo Power Project

The Redondo Power Project is a 600-MW Circulating Fluidized coal-fired plant in Subic, owned by RP Energy, a Meralco-led consortium with Aboitiz and Taiwan Cogeneration. It commenced in 2010 but was delayed due to legal challenges by environmental groups and a writ of kalikasan issued by the Supreme Court in 2012. Construction resumed only in mid-2015 after the Supreme Court on 3 February 2015 junked the petition to terminate the project. The plant should have come on stream in 2015 to ease the projected power crisis in that year. Now, it looks like it will have to wait for 2019 to be fully operational.

7. Market Power

It is often claimed that big private market players may be abusing market power in their respective area grids. GENCOS and their market shares in the Philippines and in various regions are given in **Figure 7**. In Luzon, four generation companies account for 79% of total power supply (San Miguel Power, Aboitiz Power, First Gas, and PSALM [government owned]). In the entire Philippines, these four entities account for 72% of total. In Mindanao, NPC, Psalm, and Aboitiz account for 97% of total, but Aboitiz Power, the largest private power supplier, accounts for only 18%. The rest is by government entities NPC and PSALM. This does not give less a picture of potential market power and its abuse by private players but more of the mismanagement by government of its own generation assets. Market failures may be attributed to other factors.

Figure 7: GENCOS and Market Shares in the Philippines and in Various Regions



Source: DOE

8. Market Failures

Market failures, as everyone now knows, are the necessary conditions for socially-beneficial government interventions. Government interventions may solve market failures but may also end up as government failures if (a) there is no market failure to start with, and (b) given a true market failure, the government intervention turns out to be wrong, inadequate or badly-designed or implemented. This latter state of affairs is endemic in so-called "weak states": states that do not have the autonomy to make rules and/or do not have the capacity to properly enforce the rules or implement its programs. The likelihood that government by its interventions ends up reducing social welfare rather than improving it is very high in weak states.

The Possible Market Failures in PSA:

- Possible Abuse of Market Power: GENCOS may just dictate the terms of the PSA on small fragmented DUs and ECs.
- DUs do not have the incentive to procure power from lowest cost supplier since generation cost is a *pass-on* cost to captive consumers.
- Possible transfer pricing with proprietary/affiliated GENCOS: As pointed out earlier, (1) EPIRA allows DUs to procure up to 50% of power purchases from proprietary or affiliated/imbedded GENCOS and (2) generation is considered a competitive activity, so profits of generation companies are not capped, while distribution is considered a regulated activity where profits are subject to rate of return ceiling. Transfer pricing can be attractive.

- ❖ Coordination failure: Small, fragmented DUs and ECs are unable, on their own, to aggregate their demands into bid-attractive volumes and auction them, even if they are willing to do so.
- ❖ Possible collusion between GENCOS and DUs: since DUs are not incentivized to procure at lowest cost, they could collude with GENCOS to gouge the captive customers of DUs.

The DC 06-0008 aimed to remedy these possible market failures through the following: (a) the mandated auctioning of the power purchases (PSAs) of DUs will bring these contracts into open competition; (b) the aggregation of the power demands of DUs and Electric Cooperatives (ECs), which are each too small to attract bidders, will now attract consolidators/generators. Since generation charges are pass-on costs to captive consumers (though subject to approval by the ERC), there is little incentive on the part of DUs and ECs to resist collusive proposal from GENCOS to gouge the captive consumers. If, however, the separate power demands of many DU and ECs are aggregated, they can form interesting volumes which could attract interested power suppliers, whether extant or prospective. (c) The third feature: auctioning of a large enough volume, may even attract new greenfield power units which add to the overall generation capacity of the grid/region. The cases of *Amreco* in Mindanao and *Clefcaf* in Luzon, both privately-implemented (more on these initiatives below), where the uncontracted demands of several small DUs were aggregated and successfully put up for bids with the help of NGOs, illustrate this. The winner in each case promised to put up new plants. The DC 06-0008 was intended to scale up the reputed successes of these two private initiatives. The claimed discount on the price of the power supply agreements form these two initiatives must be viewed with a grain of salt since these promised plants will be coal-fired.

Alternative Regulatory Remedies to Possible Market Failures in PSA

1. Current Method: The Accounting Method

   The ERC is the legally-mandated body for the regulation of regulated power activities. It approves petitions for tariff adjustment from DUs and the NGCP, the transmission grid concessionaire. In the process, it also ensures that the services rendered are compliant with its standards. To do this, (1) it uses the Accounting Method: its personnel evaluate petitions based on—and verify the veracity of—submitted supporting documents (with Possible Price Comparison) on, among others, the PSA contracts; (2) it conducts public hearings to elicit stakeholder scrutiny of the petition before promulgating its decisions. In all these, it faces the difficulty of discovering “fair and prudent prices.” This process is intensive in scarce time and talent resources--enough of which ERC may not have because of pay and hiring hurdles. Furthermore, the accounting method is always suspected by captive consumers of bias in favor of the DUs—a charge coming under the rubric of a popular narrative, *regulatory capture,* which partly arises from perceived moral hazard—the lack of incentives on the part of ERC examiners to be thorough, and the presumed capacity of large DUs to lobby for favorable rulings. Whatever their decision and however they uphold the balanced view, they run the risk of being publicly pilloried either as pawns of the moneyed DU lobbies or as pawns of populist lobbies. Thus, considerable regulatory delays are the normal state of affairs. It must be noted that the ERC already requires competitive selection or bidding for CAPEX reimbursement petition which reduces the required regulatory burden. In developed urban jurisdictions, organized consumer lobbies and an active press apply constant pressure on regulators and DUs towards lower tariffs. This may indeed lead to lower tariffs (Fabella, 1998). This is not true in many areas.

2. CSP as Alternative Regulatory Remedy

The market testing of PSA Contracts poses an alternative to the current accounting method to deter possible abuse of market power and other shenanigans. It has very attractive features:

- It is easier to enforce in theory: the ERC only verifies and approves (perhaps with the help of outside experts) the market test procedure (say, auction--of which there are numerous types) employed. When reassured and satisfied, it takes the auction outcome as "fair and prudent" and can do away with the tedious accounting method.
- It is so much easier to defend in public and avoids the moral hazard-related charge of bias and regulatory capture.
- When ERC is not satisfied with the private CSP, it can subject the PSA to a Swiss Challenge as part, or as extension, of the customary public hearing with stakeholders it normally conducts for the purpose. A Swiss challenge is a process by which the specification/provisions of an unsolicited bid or a negotiated contract for a project is made public and third parties are invited to tender a bid lower than the price in the negotiated contract; if no bid is tendered, the original proponent gets the contract. If a lower bid is tendered, the original proponent is aske to match the price; if the original proponent fails to match the contract goes to the the party with the lower bid. Thus a Swiss challenge is a form of a market test for the contract.

The Local Templates of CSP

The impetus for the government CSP initiative were two private local templates: the *Amreco* in Mindanao and the *Clefcaf* in Central Luzon. Both involved the aggregation of small DU and EC power demands and the auction of the aggregated volumes. Both were initiated by the private sector and NGO wherein Dr. Rowaldo del Mundo played a prominent role. The following table (**Table 2**) details some prominent facts about these initiatives.

Table 2. Experience in the Philippines: Private Initiative

MINDANAO	CENTRAL LUZON
● Association of Mindanao Rural Electric Cooperatives Power Supply Aggregation Group Corp. (AMRECO-PSAG) – 20 ECs auctioned a total of 330 MW baseload ● Signed long-term power supply contract at Php 4.12/kWh ● GenCo required to supply new power generation capacity in 2017	● Central Luzon Electric Cooperatives Association First Luzon Aggregation Group (CLECAFLAG) – 12 ECs auctioned a total of 300 MW uncontracted demand ● Signed long-term power supply contract at Php 3.70/kWh ● GenCo required to supply new power generation capacity in 2018
Note: (1) The PSA in these two cases are coal-based. Is the gain due to competition or fuel mix?	*(2) Capacity Building: The initiatives have engendered new generation capacity.*

It is claimed that the two initiatives realized substantial discount in the contract supply price. The power contracted for delivery is, however, coal-based--the lowest cost power generation. Since Meralco procurement of coal-based power is on or below the PHP 3.50/kwh (see Power Purchase Profile above), the question remains whether the discount is fuel mix-based or auction-based. The

undeniable fact is that the auction promised new baseload power capacity which will raise the total generation capacity and enlarge the power generation of the Philippines. Likewise, this widens the options of these small DUs for power supplies which can only help reduce power cost.

Potential Outcomes

Will CSP directly lower the cost of power in the Philippines? There is no guarantee of that. Will CSP crowd in new generation capacity? That is a real possibility and may help address capacity building and indirectly lower power cost. Will CSP simplify and render more transparent the regulatory burden of ERC? This is potentially the most promising outcome of the CSP exercise. Finally, since coal power enjoys a cost advantage over other fuel base and will potentially win the bids as they did in the private initiatives, CSP will have to square off with other DOE targets, such as the share of renewable.

Will the CSP address the problem of possible transfer pricing associated with incomplete unbundling of utility and generation? CSP if done properly will partly remedy the problem of sweetheart deals where the utility pays a higher price for its PSA to proprietary GenCos which is considered competitive and thus unregulated. The CSP process is never perfect and auctions can be rigged. If the ERC suspects rigging, it can subject the PSA to a Swiss challenge which will further force market testing. Previously procured long term contracts will not be subject to CSP until the current contracts expire. This means that the reach of CSP will be limited until all previously signed contracts expire. The CSP itself will become less and less important as the coverage of RCOA expands and the extent of the captive market dwindles.

Finally, we feel that utmost premium be granted to the the simplest architecture for CSP respecting the "freedom to contract" of the market economy. Building a bureaucracy behind CSP, a policy that is intendedly transitory and will become a burden when the retail competition is completed is unwise. The simplest modality is already embodied in Resolution 13 of ERC.

Part II
The Evolution of the CSP Policy

As early as 2013, the ERC, following proper consultations, had prepared a resolution mandating CSP for PSA. Although properly grounded, the ERC being the agency with the legal mandate to issue such rules, this resolution remained unsigned, and likely, sidelined in deference to the initiatives along similar lines of the DOE. In February 2014, the DOE issued a draft circular entitled: "Adoption of Demand Aggregation and Supply Auctioning Policy in the Electric Power Industry" (DASAP for short) for the purpose of consultation with stakeholders. In the middle of 2015, DOE issued the Department of Energy Circular 2015-06-0008 (DC 06-0008) which mandated three items: (i) the Competitive Selection Process (CSP) for all uncontracted demand (those not yet covered by long-term contracts) of all distribution utilities (DUs); (ii) the aggregation of the demand of small DUs into bid-attractive volumes in the run-up to the CSP; and (iii) a single transactions manager to oversee and implement all the auctions and the employment of a uniform power supply contract. As noted above, CSP is the label used for the market testing of power supply agreements (PSA) of distribution utilities. To many observers, DC 06-0008 came out of the blue. Consultations prior to its issuance were for previous DOE draft circular "DASAP", which mandated only the aggregation of uncontracted demand for small DUs in the preparation for auctioning. The apparent failure to conduct proper consultation was only one of possibly several identified legal frailties of DC 06-0008. Item (iii), the

single transactions manager for all auctions and the possible use of a single contract, ran into heavy headwind during the post-issue consultations. Another frailty: since the power to enforce a CSP resides only with the ERC, the DC 06-0008 seemed to overstep DOE's mandate. CSP was clearly the jewel in the crown while the other two items were just ancillary to CSP but hardly necessary. CSP was, in addition, the most in keeping with the pro-market leaning of the legal cover, the EPIRA Law, of the whole exercise. It was felt that the bundling of ancillary policies with end product threatened the CSP itself.

All these abstruse and expertise-intensive issues had to be resolved by 27 October 2015, when the IRR was mandated to be issued! To top it all, the position of Secretary of the DOE vacated by its holder, who was running for an elective position, had yet to be filled. Quandary among industry stakeholders was the order of the day in the run-up to 27 October: hurry the IRR and a regulatory snarl could emerge to include possible lawsuits; delay it and the DOE may be in violation of the 120-day stricture for the issuance of the IRRs. The baby was in danger of being thrown out with the bathwater!

Fortunately for the nation, a happy way out was found. It came in the form of Joint Resolution 1 dated 20 October 2015, by the DOE and the ERC. Joint Resolution 1 effectively turned over the responsibility of CSP to ERC, which put *finis* to the legal issue of enforcement. Heretofore, ERC will issue the appropriate regulations to implement CSP! Effectively averted was a possible regulatory limbo. The ERC then issued Resolution No. 13 series of 2015 which mandated that, *"Pending the issuance by the ERC of a prescribed CSP, a DU may adopt any accepted form of CSP."* Thus, CSP—the jewel in the crown, finally decoupled from ancillary instruments—can now proceed. Most importantly, it is for now the DU's responsibility to prove to ERC that the CSP employed for its PSA is transparent and competitive! In the event that a PSA submission is made without a proper CSP, the ERC can, as part of the evaluation process, subject the PSA to a Swiss challenge. This is a kind of outsourcing where government's limited capacity is resolved by bringing the market to bear. Truly the Joint Resolution 1 and the ERC Resolution 13 together constitute two steps forward to DC 06-0008's one step back

These two steps forward after one step back was in keeping with the simplicity rule that in addressing a market failure, the authorities should choose the simplest, fewest-layered, modality towards a resolution and avoid the more complicated alternatives. The latter, in view of severely limited government capacity, mostly end up as government or state failures which cost the nation plenty. Resolution 13 of the ERC means CSP is now operational! A prudent policy is for ERC to give Resolution 13 time to show its mettle since it may happen that Resolution 13 does not need any more additional tweaking. Only when it is clearly shown to need tweaking should tweaking be adopted. This is in keeping with the efficiency idea that, in weak states, intervention to perfect the market should be as simple as possible and complicating features added only as incontrovertible evidence shows how these are needed.

A truly welcome relief though it was, it was more or less just a return to the unsigned 2013 ERC resolution mandating CSP. Thus, after all the costly delay and confusions of the past two years, the operational CSP is now back where ERC left off in 2013.

The said Joint Resolution 1 was signed by ERC Chairperson Jose Salazar and the newly-installed DOE Secretary Zenaida Monsada. The latter finally accepted the standing offer to serve as DOE secretary despite her likely shortened tenure. Her acceptance and willingness to work with ERC

averted a looming regulatory firestorm. None of them was a politician eyeing to make a splash for the next election. Coordination by the two agencies rather than ownership by one agency ruled the day. Perhaps there already is a lesson there—politicians on average do not make good policymakers.

There is another lesson to be learned here. Governments, however well-meaning, many times embrace sensible ideas like CSP only to despoil them with over-ambition and overreach. Government policymakers, following logics other than economic efficiency and common sense, tend to go for too big a bite even if followed by a harvest of massive social indigestion. Friedrich Hayek (1991), 1974 Economics Nobel Memorial Prize winner, called this tendency among state policy makers a "fatal conceit"—the inability of state actors to recognize their own limits to improve on markets. "Hubris" is its name in popular parlance. Surely, most markets are imperfect; but perfecting these markets calls most times for "policy nudges", not for a radical lobotomy which kills rather than heals. In the case of CSP, DC 06-0008 was a threatened lobotomy. In this rare instance, DOE and ERC hammered out an exception to the Hayek fatal conceit. Would that exceptions like this become the rule in the future. No guarantees but we are given a fillip for hope.

References

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