INSTITUTE FOR CLIMATE AND SUSTAINABLE CITIES

# COVID-19: LESSONS FOR THE PHILIPPINE POWER SECTOR

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WHEN the novel coronavirus first appeared in China late last year, nobody expected that the new disease, officially dubbed Covid-19 by the World Health Organization in February 2020, would become a global pandemic. Advanced and developing economies were ill prepared for its impact. Public health systems were overwhelmed. Broad and restrictive quarantine measures, including lockdowns, were imposed, severely restricting global and domestic economic activity. The preliminary numbers indicate the impact on the global economy will be worse than the financially-induced global recession in 2007-2009.

The country's financial and economic managers strived to mitigate the pandemic's effects on the marginalized sectors by realigning budgets and mobilizing new funds from borrowings. Opportunely, the country's strong macroeconomic fundamentals made this possible.

The spread of the virus has impacted industries, including the power sector. Despite burden sharing among consumers and major players in the main grid, power system inflexibility may translate to either higher cost for consumers or losses for inflexible generators. Opportunities with flexible generation certainly deserve separate discussion among power sector policy makers and players. For sure, the new normal will reflect broad structural changes, in turn affecting the energy intensity of the economy in the short, medium, and long term.

To address the impact of the enhanced community quarantine, the Department of Energy (DOE) and the Energy Regulatory Commission (ERC) acted promptly to ensure stable power supply by making sure the wholesale electricity spot market would continue to operate amid the challenges faced by the transmission, distribution, and generation sectors. The DOE also ensured that frontline workers in the sector are authorized to travel and provided with sufficient health protection.

There are, however, downsides to the responses under the current regulatory system.

First, the spot market, based on central economic dispatch predicated on variable costs, ensures that the generation mix would always be least-cost in the short run. However, even prior to Covid-19, market results had been distorted by take-or-pay natural gas fuel-supply contracts that lead to higher costs. On the other hand, the crisis has accentuated the advantages of variable renewable energy (VRE) in keeping prices low and stable. Supply from VRE, especially those under the Feed-in-Tariff system, had stable prices. The low-demand situation also accentuated the merit-order-effect on spot prices. Further, the low-demand situation also highlighted the unfolding advantages of renewable energy and natural gas over coal supply, as shown by data from the Independent Electricity Market Operator of the Philippines. The generation reduction came almost entirely from coal capacity, and barely scathed natural gas operators.

Secondly, the must-offer rules for capacity meant to guarantee competition might have a perverse effect on costs, and need to be reexamined. Covid-19 has induced a demand reduction like no other since the market was launched in 2006. Maintenance rescheduling due to low demand could be construed as anti-competitive behavior under current rules, even though rescheduling makes economic sense. Energy Secretary Alfonso Cusi encouraged generators to take advantage of the low demand to schedule preventive maintenance.

For end users, Meralco offered a 30-day payment extension for bills due from March 1 to April 14, which was later adopted by ERC for all franchise areas. The ERC subsequently mandated that all consumption during the quarantine period—under bills falling due in March, April, and May—should have a payment deadline not earlier than June 15. The deadline extensions and the installment plans had affected and will continue to affect the cash flows of the industry players over several months. Utilities will in turn need to extend deadlines for payment to the generation sector.

Meralco has faced numerous criticisms by the Joint Congressional Energy Commission (JCEC), the DOE, and ERC over the lack of transparency and inadequate communications that led to anxiety over "bill shocks". The utility has promised to address these concerns immediately.

Meralco experienced a fall in peak demand of almost 40 percent to 4,516 megawatts (MW) in March 2020 and further to 4,289 MW in April. As a result, the country's largest distribution utility promptly invoked force majeure provisions in its power supply agreements – seven contracts with three conglomerates in the power sector. Consent was granted by Ayala, San Miguel and Aboitiz, according to Meralco VP for Utility Economics Lawrence Fernandez. Otherwise, end-users already saddled with minimal or no income during the lockdown would face higher per kilowatt hour (kWh) rates owing to lower capacity utilization. Estimates by the Senate Energy Committee indicated that per kWh rates in Luzon and the Visayas would have risen by 15 percent and 5 percent, respectively.

Almost all electric cooperatives, due to lack of negotiating power by virtue of their size, were not able to avail themselves of force majeure. According to the Philippine Rural Electric Cooperatives Association, of the 59 electric cooperatives that suffer from higher unit electricity rates because of lower utilization of contracted capacity, only two have managed to negotiate with their suppliers. Electric cooperatives sought the assistance of ERC to trigger negotiations on force majeure arguments. During the JCEC hearing, ERC Chairman Agnes Devanadera promised to deal with the problems of the cooperatives on a case-to-case basis, upon prodding by JCEC cochairman, Senator Sherwin Gatchalian.

On the positive side, mainly shielded by the effects of Covid-19 are the contestable electricity consumers procuring power from retail electricity suppliers. In the Luzon grid, where the preponderance of contestability, i.e., five of nine gigawatts (GW) of demand is already eligible, with 80 percent of the 5 GW under retail supply contracts. Most of these contracts that impose volume and price risks on suppliers took effect after 2017. Expanding the scope of retail competition as mandated by the Electric Power Industry Reform Act (Epira) remains in legal limbo at the Supreme Court. In fact, templates of post 2016 retail supply contracts explicitly identified "pandemics" as a force majeure event. Thus, small consumers continue to be held captive by the procurement decisions of the distribution utilities.

***The economy-energy nexus and opportunities in the power sector***

In addressing the economic crisis induced by Covid-19, the National Economic and Development Authority (Neda) under Secretary Karl Kendrick Chua has proposed an economic recovery plan addressing the sectors most severely hit by the pandemic. The plan addresses liquidity problems through loans and targeted, time-bound, and conditional equity infusions. We hope that the conditionalities would be anchored on sustainable development criteria so we can aim for a better, not just new, normal.

The downgrade in the economy's growth trajectory means power sector capacity additions will be delayed. The DOE has revealed that electricity demand fell by 30 percent in Luzon, 17 percent in the Visayas, and 25 percent in Mindanao. The delay provides an opportunity for the DOE to reset energy development policy by enabling flexible energy generation, allowing greater renewable absorption in the grids, and redirecting resources to support energy price stability.

The country's financial regulators have been proactive in safeguarding the financial system, while enabling opportunities for the post-Covid-19 recovery and growth period. In April 2020, the Bangko Sentral ng Pilipinas(BSP) approved the Sustainable Finance Framework to safeguard the financial system from evolving transition risks including stranded assets and to value low-carbon opportunities. The BSP framework complements the mandatory environmental, social and governance reporting guidelines for publicly listed companies starting 2020 previously issued by the Securities and Exchange Commission. For the Southeast Asian region, the Asean Green Bonds Standards was released in 2018 to jumpstart green finance. In 2019, the Philippines listed $2.02 billion of green bonds. Green bonds are effective in addressing investment and liquidity needs through the capital markets.

Under the current regulatory design, the investors and operators of inflexible power are shielded from the impacts of fuel price and demand fluctuations in their contracts—"unless force majeure conditions are successfully invoked." Their income is guaranteed through adjustments in electricity bills of captive households and small businesses that can ill afford it. Equitable risk sharing among all parties involved in the transaction should be standardized in the power supply agreements. Force majeure clauses should protect the interests of end-users, while incentivizing utilities and power generators to procure flexible and least cost generation. The competition bill in the power sector (Senate Bill 1653) prepared by the Senate Committee on Energy can enable the policies under various laws meant to enhance consumer protection and market competition.

The smallest consumers should have enjoyed the benefits of Retail Electricity Supply and Open Competition many years ago, as envisioned under the Electric Power Industry Reform Act of 2001. But the pandemic provides the power sector with opportunities to put in place far-reaching reforms. It's time to seize the day.

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