

Getting Energy Right: A Call to Action

Secretary Raphael P. M. Lotilla
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I made sure that I would not miss on this opportunity if only to share with you our performance commitments in the energy sector and to agree on common measures responsive to the requirements of the business community, as we work together to address this nation's energy challenges.

The Philippine business community is critically important to the turnaround of the economy. Your support is vital to making positive change. And your voice and support carry well outside Manila to investors, bankers, credit agencies and multilateral institutions that are examining the pace of reform in the Philippines.

The President is completing the First Phase of her economic reform agenda and it is important to remember the progress we have made amidst the skepticism that abounds: Passage of the sin taxes...Passage of the accountability legislation at BSP...Passage of a fiscally responsible national budget...The imminent passage of a VAT...The launch of programs to crackdown on the tax evaders...And many more anti-corruption efforts.

But we cannot rest, and I can assure you, we won't. Phase Two rests on the need to get the Napocor debt off the nation's books, privatize energy and develop our natural resources. And we don't have time to wait. That is why I am here today.

I took my oath as Secretary of Energy barely three weeks ago, and have hit the ground running starting from Day One.

I have accepted the responsibility of leading the energy sector, including the need to manage the challenges, constraints and sacrifices inherent in the job.

My performance contract with the President is as clear as day. Pursue energy independence. Pursue power sector reforms. And do it now.

And in so doing, to make sure that energy is accessible, sufficient, stable and secure. And more importantly, that it is reasonably priced for both business and consumers.

Today, I want to report on a short-term 8-point plan of action I have undertaken to accelerate our energy program:

One: To accelerate energy independence, we will proceed rapidly with the Second Contracting Round involving the auction of petroleum, geothermal and coal blocks. As of May 1, we will impose a moratorium on all new applications in order to focus on the auction.

Two: I have directed that negotiations on a market price for the CNG fuel needs of buses beyond the pilot 200 units commence in two weeks.

Three: I have tasked a review of the Renewable Energy bill to redefine geothermal resources as a mineral to more rapidly expand development of that industry.

Four: We are working with the Department of Justice to address anti-competitive behavior or other violations of the Downstream Oil Deregulation Law. Our recommendations to strengthen this law will be submitted within the month to the Independent Committee to review the Oil Deregulation Law.

Five: To move power reforms forward, I have directed NPC and PSALM to complete negotiations, within a week's time, on power supply contracts representing at least 70% of our power supply.

Six: We are moving ahead aggressively to launch a trial of the Wholesale Electricity Spot Market (WESM) that we believe will lead to transparency and competition in the power sector and ultimately better prices for business and consumers. We will commence on Monday, April 18.

Seven: We have given approval to sign, upon concurrence from the Department of Finance, a landmark MOU with the ADB for a proposed Power Sector Development Program that will help reform our power sector and address the negative impact NPC is having on our nation's fiscal situation.

Eight: We are working with the private sector to speed up initiatives to promote energy conservation.

You all know the challenges facing the energy sector today and that is why we must accelerate our plan of action.

Oil Situation

The foremost challenge facing us is the sharp increase in world oil prices. Since 2004, upward price pressures have pushed the average price of oil in previous weeks to about US\$50 a barrel.

Based on the Oil Market Outlook released the other day by the International Monetary Fund, oil prices will continue to be high and volatile at the range of US\$39 to US\$56 per barrel in the coming years. World petroleum demand will continue to grow robustly with 2.7 percent growth during the year as against a tight growth in supply of 2.2 percent.

China and India have been singled out among the non-OECD economies for contributing about 35 percent in incremental oil consumption between 1990 and 2003. Their economies are still growing.

As an oil importing country, we need to brace ourselves for tough times.

Energy Independence

In this context, the President is pushing for energy independence as one of the pillars of our development strategy.

If we want industry to be competitive, if we want to bring down production costs in the medium to long-term, if we want economic growth with job creation, then we should not allow ourselves to be dependent on imported energy and consequently be held hostage by volatile international prices.

Action Agenda for Energy Independence: Opportunities for the Private Sector

Let me tell you more about the Action Agenda we have established within DOE.

We shall proceed with the Second Contracting Round involving the auction of petroleum, geothermal and coal blocks. To pave the way for the bidding out of these blocks, a moratorium on new applications for negotiated service contracts for petroleum, geothermal and coal shall commence on 1 May 2005. This takes away the debate between negotiations and bidding.

Each petroleum block covers an area of around 12,000 square kilometers. Several prospective areas in offshore West Palawan and Sulu Sea will be offered to interested investors. The petroleum sedimentary basins located in these areas are considered to be the most prospective in the Philippines for petroleum exploration.

On the other hand, geothermal blocks shall be bid out for power and non-power purposes. The latter include multi-crop drying, salt-making, refrigeration by absorption, and yes, even hot bath and spa.

Coal potential remains high. Locally produced coal supplies about 20% of the country's 10 million tons per year coal requirements, thus there remains a vast market for additional coal production for clean coal power generation and the cement industry.

I have also directed that the draft Renewable Energy bill be reviewed in thirty days on whether, within the context of our Constitution, we can consider the economic necessity of defining geothermal resources as mineral resources. This would allow the utilization of geothermal resources to be made on the same basis as the rest of the mining industry. We have precedents for this in other areas of the world and would not be violative of the Constitution. In the Philippines, this would allow the entry of much needed capital for the fullest utilization of the country's geothermal resources on the same terms that the Supreme Court has recognized for the mining sector.

To expand the pilot project for buses using Compressed Natural Gas (CNG) beyond the initial 200 units, negotiations on a market price for CNG will commence in two weeks time. We call on the private sector for investments so that our target to have all our buses in Metro Manila running on CNG by 2010 is achieved.

The construction of the Shell daughter station for the Compressed Natural Gas (CNG) Pilot Project resumed last Monday, 11 April 2005, along PNCC's South Superhighway in Binan, Laguna after having been interrupted since 22 March 2005. This project is essential if we are to roll out the first CNG-fueled buses in the country. I have asked PNCC and the local government to give the project their fullest support and to see it through its uninterrupted construction and operation.

Together with Justice Secretary Raul Gonzales, I convened the DOJ-DOE Task Force established under the Downstream Oil Deregulation Law to review the mandate of the Task Force in running after anti-competitive behavior or other violations of the law. The Task Force will make its assessment and recommendations as its contribution to the work of the independent Committee to Review the Downstream Oil Deregulation Law. The independent Committee has been conducting its consultations with the various sectors and will be submitting its recommendation on or before the end of May. I call on the private sector to cooperate fully with the Committee as we seek to strengthen the framework for doing business in this subsector.

Energy Conservation

The measures I just have cited are on the supply side. The more important and immediate concern that involves the cooperation and support of everyone—from the government, industry and even our nation's household—is our commitment to the discipline of energy consciousness, efficiency and conservation.

The government has led the way with the implementation of the four-day workweek, to cut costs on fuel, oil, electricity and other utilities and to allow 1.1 million government employees to save on food, transport and incidental expenses during the summer months. I am glad to report that the feedback has been positive so far.

In the report of the International Energy Agency to be released in May 2005 entitled *Saving Oil in a Hurry*, demand restraint policies are being suggested to dampen surging oil prices, one of which is the compressed workweek, which we are now implementing.

You in the business community also have an important role to play in pursuing demand-restraint measures. The resonant response of business leaders at an Enercon meeting last week at the Palace reflects leadership and its desire to act for the public good. We therefore welcome your commitment to do more with less, balancing the requirements of increased productivity with less energy.

I leave the details to you. You are in a better position to know what are within your control given your resources and what you can immediately do for the ENERCON given your commitment.

I call on the private sector to work fully with Mr. Meneleo Carlos who has accepted the responsibility to chair the private sector's efforts in energy conservation.

Power Sector Reforms

The major challenge that is more persistent than the oil price hike is our fiscal situation, particularly managing the debts of the National Power Corporation.

The President has made it clear: power sector reforms are the most important building blocks of our fiscal reforms, addressing our fiscal challenges caused substantially by NPC losses.

But while we take this commitment seriously, we need to remind our people that these reforms are intended to make the cost of electricity competitive with the rest of the region without sacrificing adequacy, reliability and quality.

Congress, through the EPIRA, has set our performance commitments. The roadmap for reform has been defined. We need to create a competitive electricity market by moving on with the restructuring of the electric power industry.

We will use the competitive forces of the market and the regulatory powers of the State to ensure adequate, reliable and secure energy.

A key move in this direction is the MOU we expect to sign soon with the ADB for a proposed Power Sector Development Program. Under this program, the ADB will support the power sector policy objectives and programs of our government. The ADB will assist us to restore the financial viability of the power sector through moves to reduce and eliminate NPC's losses.

To reduce further NPC's debt service requirements, the ADB will extend a partial credit guarantee that will support refinancing of some NPC's loans on softer terms. The ADB assistance would also include an investment component and partial credit guarantees to deal with the credit risk of energy off-takers in the electricity spot market. This will be a major step forward in our efforts to reform our power sector and address the negative impact NPC is having on our nation's fiscal situation.

Privatization

We need to vigorously pursue the privatization of generation and transmission assets of NPC.

PSALM is pursuing an accelerated sale strategy to bring assets to market as quickly as possible to take advantage of positive buyer sentiment, and under a plan that

maximizes value within PSALM's procedures and limitations for fair and transparent auctions.

A key feature of the strategy for accelerated asset sale is the Investors' Preliminary Asset Review Process (IPARP), which allows potential bidders to undertake due diligence activities on power plants they are interested to bid for even prior to formal call for bids. This will shorten the due diligence stage, the most time-consuming activity in the formal bidding process. PSALM will also very shortly pilot a virtual data room for the power plants to further facilitate due diligence activities.

I am inviting on all parties involved to take a closer look at the assets PSALM and NPC have to offer, and I am calling on the major distribution utilities to give their full support to the power reform program.

I have directed NPC and PSALM to see to it that negotiations on the power supply contracts are completed within a week's time from today.

The EPIRA requires NPC to file for the ERC's approval within six months from the effectivity of the law a transition supply contract duly negotiated with the distribution utilities containing the terms and conditions of supply covering a period not extending beyond one year from the introduction of open access. The supply contracts can be attached to the NPC plants to be sold, thus maximizing their value. In the event that no agreement is reached, then NPC and PSALM shall submit their proposed power supply contracts to the ERC for an appropriate ruling.

In the meantime, NPC and PSALM shall proceed with forward sales agreements that would involve sale of future power output to other interested parties.

We are also committed to bid out the Transco concession within this year through open and competitive tender process. I expect the private sector to seize the opportunity to operate the Transco concession.

To make sure that all the pieces are in place, I have organized an Electricity Reforms Action Team from among the different power agencies. That Action Team will address identified gaps in the implementation of the EPIRA and build a common data base for policy and regulatory purposes among the DOE, the WESM, and other power corporations. The data base will be made available to the Energy Regulatory Commission to foster information-sharing and the pooling of efforts and resources.

Wholesale Electricity Spot Market

The wholesale electricity spot market (WESM) is the mechanism for electricity trading among generators, suppliers and wholesale consumers with the objective of promoting competition in electricity supply production. By January 2006, we expect full commercial operation of the WESM in Luzon.

The Wholesale Electricity Spot Market begins its trial operation on Monday, April 18. This represents the final preparations for the commercial operations of the WESM.

If successful, the WESM will usher in a new electricity industry, where transparency and competition will lead to greater efficiencies and eventually, reasonable prices for the consumer, whether they be households or industry.

While efforts to reach this critical juncture have been spearheaded by government, the spot market cannot succeed on sheer mandate. Industry must take on a more proactive role in the reform process and the establishment and operations of WESM. Participation in the trial operations whether as a trader or an observer, is an opportunity to review and comment on the market rules, test the market systems, become familiar with the future pricing mechanisms of electricity, and begin planning for open access when you will be able to begin treating electricity as an input into your business and to make economic decisions on how you contract, purchase and trade this essential commodity.

Open Access and Retail Competition

Open access and retail competition empower the customers to choose their electricity providers who offer the best possible price. Apart from the establishment of the WESM, we are committed to having in place the remaining EPIRA conditions for open access by July 2006. This includes the privatization of at least seventy percent of the total capacity of generating assets of NPC in Luzon and Visayas, and the transfer of the management and control of at least seventy percent of the total energy output of power plants under contract with NPC to the IPP Administrators.

For open access and retail competition to succeed, we need a distribution sector, which can act as viable off-takers for new projects. We cannot keep on asking the government to provide guarantees and other forms of performance undertakings. We therefore need to work well with the distribution utilities and electric cooperatives on this. We will need to grow a new retail business as well, which is able to innovate and offer value to end-users.

Reflective Costs in the Pricing of Electricity

You are all aware of NPC's petition before the Energy Regulatory Commission for more reflective costs in the pricing of electricity. This will stem NPC's losses and greatly contribute to addressing the fiscal problem. If approved, the petition may mean short-term higher electricity rates, but the incentive for us is to change our consumption habits—one, by reducing our electricity consumption and two, by shifting our energy-intensive activities to non-peak hours.

The adoption of time-of-use pricing approximates the true cost of power at different times of the day. This will encourage more efficient utilization of existing generating

capacities and allow end-users the option to use electricity during off-peak hours when electricity is less costly.

For industries and our export sector, the Energy Regulatory Commission's full removal of inter-grid cross subsidies by October 2005, will also represent rate relief.

The lifeline subsidies will continue to cushion the impact of these rate adjustments on the poor. While the Energy Regulatory Commission has committed to review the existing lifeline rate structure to ensure better targeting, the existing lifeline rate structure is far better than the block rates implemented before EPIRA.

Sufficient and Reliable Supply of Electricity

As you know, we need new infrastructure capacity from the private sector to meet the country's energy requirements.

We expect privatization to provide opportunities for new owners of generating plants to expand capacities in existing installations. There are also opportunities for new investments in new and renewable energy in off-grid areas or extending electrification via hybrid systems, for instance combining diesel and wind.

Systems loss and efficiency improvement programs will also help provide quality, reliable and cheaper electricity service. NPC's commitment to improve the heat rate efficiencies of its plants will result in fuel savings. NEA is also committed to help lower the systems loss of electric cooperatives by 1 percent every year from 13 percent in 2004 to 9 percent in 2009.

Access to Electricity

In keeping with the President's 10-point agenda, DOE is working on achieving total electrification of the country at the *barangay* level by 2008. We are committed to finish this priority program starting from 92.5 percent electrification in 2004, we will move to 95.0 percent in 2005, 97.5 percent in 2006, and 98.8 percent in 2007.

We are pursuing the entry of the private sector in providing electricity to remote unserved areas. We are working on changing the institutional arrangements for the private sector to assume a more active role in augmenting the government's missionary electrification program and in helping distribution utilities and electric cooperatives to expand service coverage in their franchise areas.

The efforts to open to the private sector in Fourteen "First Wave" areas served by NPC SPUG or missionary electrification unit will allow NPC to address 80 percent of losses arising from NPC's missionary electrification mandate. We expect this first 14 to be completed by 2006, with complete roll out of the first three pilot areas in 2005.

Closing Remarks

In outlining our energy independence agenda and roadmap for power sector reforms, I cannot overemphasize the private sector—your role in making these reforms successful. We need the private sector to supply the entrepreneurial spirit.

We need your help in explaining to our people the necessary adjustments we have to make—painful they may seem to be now but necessary for upholding the general welfare in the long-term.

President Arroyo has chosen the difficult but necessary path with her reform measures. She understands that many of the fundamental changes she is making—on revenue, taxation, fiscal restraint and energy independence—can be painful. This is particularly so for the poorest in the nation. And she is paying a political price for it. But she is determined to make the changes and accept the price of popularity if it can move the nation, particularly the poor, forward.

The patience of our people is wearing thin. And therefore we need to move and demonstrate results in our reform agenda, in the direction of more sustainable energy systems, economic and fiscal reforms and public welfare.

Your DOE is accountable for the stewardship of the country's energy requirements. This stewardship will only be meaningful if based on shared principles and close cooperation with you and all stakeholders.

I shall always look for your support and close cooperation as we move quickly to reform our energy sector and deal with the ever-changing challenges we face. We can only do this if we work together to implement this Action Agenda.

Thank you.