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PROMOTING INVESTMENT MANAGEMENT CONTRACTS AS ONE MEASURE IN EFFECTING GREATER PRIVATE SECTOR PARTICIPATION IN THE MANAGEMENT AND OPERATION OF RURAL ELECTRIC COOPERATIVES PURSUAN...

DOE DEPARTMENT CIRCULAR NO. DC 2004-006-007, June 18, 2004

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WHEREAS, under Section 2 of the Republic Act 9136, otherwise known as the "Electric Power Industry Reform Act of 2001" or "EPIRA," it is declared policy of the State to:

(i) ensure and accelerate the total electrification of the country;
(ii) ensure the quality, reliability, security and affordability of the supply of electric power; and
(iii) enhance the inflow of private capital and broaden the base of the power generation, transmission and distribution sectors.

WHEREAS, pursuant to Section 37(e)(i) and (ii) of EPIRA and Section 1, Rule 3 of the Implementing Rules and Regulations of EPIRA or "EPIRA-IRR," the Department of Energy (DOE) is mandated to encourage private sector investments in the electricity sector, and to facilitate and encourage reforms in the structure and operation of distribution utilities for greater efficiency and lower costs;

WHEREAS, pursuant to Section 37(e)(p) of EPIRA and Rule 3 of EPIRA-IRR, the DOE has the responsibility to formulate such rules and regulations as may be necessary to implement the objectives of EPIRA;

WHEREAS, pursuant to Section 43 of EPIRA, the Energy Regulatory Commission (ERC) shall, inter alia, promote competition, encourage market development, and ensure customer choice in the restructured electricity industry;

WHEREAS, pursuant to Section 58(b) of EPIRA and Section 3, Rule 3 of EPIRA-IRR, the National Electrification Administration (NEA) is mandated to develop and implement programs to strengthen the technical capability and financial viability of rural electric cooperatives;

NOW, THEREFORE, FOR AND IN CONSIDERATION OF THE FOREGOING PREMISES, the DOE hereby promulgates the following guidelines to promote private sector partnership and participation in the operations of rural electric cooperatives or "ECs" toward sustainable financial viability, enhance ECs access to private capital, and to improve services to electricity end-users.

SECTION 1. Definition of Terms.

Unless the context otherwise indicates, the terms used in this Circular shall have the following meanings:

(a) "Department of Energy" or "DOE" refers to the government agency created pursuant to Republic Act No. 7638 whose expanded functions are provided under EPIRA;

(b) "Electric Cooperative" or "EC" means a distribution utility organized pursuant to Presidential Decree No. 269, as amended, or as otherwise provided under EPIRA;

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(c) "ERC" means the Energy Regulatory Commission established under Section 38 of EPIRA;

(d) "Investor-Operator" may include, without limitation, private firms, non-governmental organizations, cooperatives, distribution utilities, generation companies, or subsidiaries of distribution utilities or generation companies, or combinations thereof to embrace such groupings as joint ventures, consortia, and partnerships;

(e) "Investment Management Contract" or "IMC" refers to one of the modalities of private sector participation in the management and operation of electric cooperatives further described in Section 3 of this Circular;

(f) "LGU Guarantee Corporation" or "LGUGC" refers to the entity appointed by the DOE, to manage a credit guarantee program to enhance EC credit worthiness;

(g) "Memorandum of Agreement" or "MOA" means the agreement to be entered into and executed by and between the DOE, NEA and an EC which sets out the terms and conditions of the process to be observed in assisting the EC in establishing the partnership between the private sector participant and the EC;

(h) "National Electrification Administration" or "NEA" refers to the government agency created under Presidential Decree No. 269, as amended, and whose additional mandate is further set forth under EPIRA; and

(i) "Person" refers to a natural or juridical person, as the case may be.

SECTION 2. Declaration of Policy - It is hereby declared the policy of the DOE for ECs to achieve the readiness to compete in the restructured and competitive electricity market. Towards this end, the DOE is implementing, supporting and promoting programs and projects to urge ECs to undertake structural and operational reforms with a view to achieving greater efficiency and lower costs, through collaboration with the private investor-operator/s to gain access to private sector capital and management expertise.

The DOE recognized that reform options ECs may consider include, but are not limited to, the following:

(a) Collaborative efforts with private sector participants, such as an investor-operator, under IMCs;

(b) Amalgamations, either through a merger, consolidation or regional joint management arrangements; and

(c) Conversion into Stock Cooperatives under Cooperative Development Authority (CDA) or Stock Corporations under the Corporation Code.

As regards IMCs, it is hereby further declared the policy of DOE to support only IMC transactions concluded through a transparent and competitive bidding process, where the resulting IMC offers the EC an arrangement which is transparent, long-term, competitive, comprehensive, and demonstrates sustainable solution for the efficient operation of the EC.

It is the stated policy of DOE that it will provide all necessary support to ECs interested and/or participating in the implementation of IMCs.

SECTION 3. Essential Features of the IMC.

The IMC, as duly endorsed by the DOE, is a contractual relationship between a willing EC and a willing investor-operator, for the infusion of risk capital and provision of management expertise by the latter to the former, to provide for sustainable EC recovery based on improved efficiency, lower costs and systems losses reduction.

The essential features of the IMC are:

(a) The EC remains the duly authorized distribution utility; hence, members of the EC, through the EC Board,

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shall continue to exercise the rights and responsibilities under its franchise. It shall continue to be regulated by the ERC.

(b) The EC will continue to function and act through its Board, which shall retain critical residual powers under the IMC, such as, but not limited to:

> (i) monitoring performance of the investor-operator to ensure compliance with agreed performance standards and deliverables; and
>
> (ii) working with the investor-operator to approve and implement an investment program consistent with achieving on-going compliance with the Distribution Code

(c) The EC will retain ownership of and strategic control of its assets, as well as control over setting the standards of service to its customers.

(d) To ensure that the EC is adequately protected and reasonably assured of sustainable recovery, the investor-operator will only obtain a return on investment and so remunerated where systems loss reduction is achieved and costs are considerably decreased, through an equitable profit-sharing and/or lease option scheme.

SECTION 4. Issuance of NEA Memorandum.

As an expression of its support for and endorsement of IMC, the NEA shall, within thirty (30) days from the promulgation of this Circular, issue a memorandum substantially setting out the following:

(a) Endorsement of the IMC, as defined in Section 1(e) hereof and with the essential features set out in Section 3 of this Circular, to qualified ECs. It is acknowledged that the IMC has the dual purpose of providing ECs with access to capital, they could not otherwise obtain, and improving performance incentives.

(b) Recognition of the participation of the DOE-appointed Transaction Advisor (as provided in Section 5 hereof) in the implementation of IMCs, to ensure that a transparent and competitive bidding process is undertaken to tailor the IMC to the needs of participating qualified ECs and to match a suitable investor-operator with and EC.

(c) Encouragement by NEA for ECs to consider the IMC, and in doing so, to further avail the services of the Transaction Advisor in undergoing the IMC process. Towards this end, ECs are further advised to enter into a Memorandum of Agreement (MOA) with the DOE and NEA which shall be followed in qualifying an EC and facilitating the IMC transaction with the investor-operator. The MOA sets out the terms and conditions of the IMC process.

SECTION 5. Guided Transaction Process.

To facilitate a transparent and competitive bidding process, the DOE has appointed a Transaction Advisor. The Transaction Advisor has been engaged to act as the transaction process guide and independent broker between the EC and an investor-operator, to ensure that a transparent and competitive bidding process is in place and is undertaken to tailor the IMC in a manner suitable to the EC, while at the same time making the transaction attractive to potential investor-operator/s.

DOE has instructed the Transaction Advisor to develop a best-practice model IMC, which protects and advances the interests of EC and its members.

ECs desirous of exploring the IMC option are strongly encouraged to avail themselves of the services of the Transaction Advisor, duly appointed by the DOE. Interested ECs are thus invited to enter into a MOA with DOE and NEA, which will set the terms for the support that each EC will receive at various stages of the IMC transaction process.

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SECTION 6. Support for and Regulation of ECs under IMCs.

The end-users shall be protected from any rate increase arising from the IMC transaction. On the other hand, the DOE is cognizant of the need for investor-operator to achieve the required returns on their investments once the target EC performance is met and operating surpluses are realized. Investor-operators need to be protected from the risk that such surpluses are dissipated through regulated rate reductions. Accordingly, the DOE and ERC will consult and petition the ERC for development of a special regulatory regime for ECs under private sector partnerships, under which ECs can opt into a locked-in tariff path. Such tariff path will provide certainty both to consumers and potential investor-operators.

The DOE has also appointed the LGU Guarantee Corporation (LGUGC) to manage a credit guarantee program designed to enhance EC credit worthiness. This program, funded by the Global Environment Facility and the World Bank, aims to provide partial credit guarantees to local Philippine banks (financial institutions) for loan to ECs or investor-operators. The DOE shall encourage LGUGC to support the implementation of IMCs, by recognizing such contracts as significant contributions to reducing credit risk.

SECTION 7. Repealing Clause.

All pertinent issuances, circulars and memoranda inconsistent with this Circular are hereby amended or repealed accordingly.

SECTION 8. Saving Clause.

(a) If for any reason, any provision of this Circular is declared unconstitutional or invalid, the other parts or provisions hereof which are not affected thereby shall continue to be in full force and effect.

(b) The implementation of this Circular shall not exempt the parties from complying with applicable laws and government rules and regulations.

SECTION 9. Effectivity.

This Circular shall take effect within fifteen (15) days upon publication in newspaper of general circulation.

Adopted: 18 June 2004

(SGD.) VICENTE S. PÉREZ, JR.
Secretary

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