

## **FREE-MARKET-COMPETITION HOAX IN THE WHOLESALE ELECTRICITY SPOT MARKET FROM DEFECTIVE PRIVATIZATION**

### **THE DISGRACE TO LAWYERS AND ECONOMISTS IF ALLOWED TO CONTINUE: FREE-MARKET-COMPETITION HOAX IN THE WHOLESALE ELECTRICITY SPOT MARKET (WESM)**

#### **The Smoking Gun of Lack of Competition in the EPIRA-Deregulated Power Generation Oligopoly: WESM Bidding System that is Simply Ridiculous and Devoid of Competition—it is a Game of Chance!**

There is simply no price-lowering competition in the touted WESM purchase bidding system, which declares as winner the *last bid* received among the hourly batch of bids even if it is the *highest bid rate*—and declares as losers all other bids, including the most advantageous *lowest bid* rate among the bids received. In other words, under the absurd bidding scheme, the award is based on circumstance, not on merit (p. 170).

#### **To Begin With, Who are Behind the EPIRA-Mandated Wholesale Electricity Spot Market?**

Quotes from economist Solita Monsod's "Get Real" column in the *Philippine Daily Inquirer* on December 13, 2014, page A12, "Who's responsible for power price spike?":

"The Epira (Electric Power Industry Reform Act) of 2001 mandated the Department of Energy (DOE) to establish the Wholesale Electricity Spot Market (WESM) that would 'facilitate a transparent and reliable market for electricity, and, jointly with the electric power industry participants, formulate the detailed rules for the WESM.' This the DOE did, with inputs from the industry participants.

"The Epira also entrusted to the Energy Regulatory Commission (ERC) the approval of the price determination methodology, which it did with the proper consultation.

“An ‘autonomous group market operator,’ the Philippine Electricity Market Corp. (PEMC) composed of industry participants—involved in generation, transmission, and distribution—was also created, chaired by the DOE. Its role was to ‘procure necessary infrastructure and technology, and achieve institutional and participant readiness for the commercial operation of the WESM.’ With the DOE as chair, the board members of PEMC, aside from the ERC, are representatives of the generators, transmitters, and distributors, plus four independent members (presumably representing consumers).

“I bring this out to show that the government was very visible in making the market rules (WESM).”

(It is obvious that there had been no representatives or inputs from known consumer groups in the formulation and implementation of the WESM rules, a blatant lack of protection to taken-for-granted consumers. --M. L. Tecson)

### **JUST WHAT IS WRONG WITH THE WHOLESALE ELECTRICITY SPOT MARKET?**

Based on media reports and commentaries, WESM operates a ridiculous game-of-chance procurement bidding system, under which ***whatever is the last quoted price in the hourly batch of bids—even if it is the highest bid price, and even if there is a zero-amount bid quotation—becomes the winning bid!***<sup>86</sup>

Under the outlandish WESM bidding rules, the winning suppliers and bid prices are separately determined, a ridiculous deviation from the conventional method where the bidder submitting the lowest bid price becomes the winning supplier. In WESM, the two modes of bidding competition are as follows:

1. The bidder which submitted the lowest bid rate becomes the winning supplier, from which the needed power supply will be purchased. This explains why some bidders submitted bids at zero price. (The bidding will, of course, turn to naught or absurdity if all bidders would submit zero bid rate.)

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<sup>86</sup> Solita Collas-Monsod, “Get Real: Who’s responsible for power price spike?” *Philippine Daily Inquirer*, December 14, 2013, p. A12.

2. As presented herein later, as Meralco lawyer Victor Lazatin himself in effect indirectly admitted during oral arguments before the Supreme Court in February 2014, on the contested ₱4.15 per kWh Meralco rate increase reportedly approved by ERC in one hearing session, the winning bid was determined not based on merit but by mere expeditious if illogical mechanics where whichever is the bid price of the last bid in the hourly batch of bids becomes the winning bid rate even if it is the highest bid price, to be applied to the sales-volume offer of the winning lowest bidder, such as the one which submitted the zero bid rate per kWh.

In the briefing conducted by ERC on February 9, 2017 at the request of United Filipino Consumers and Commuters (UFCC), held at the ERC offices in Ortigas Center in Pasig City, the lecturing ERC technical staff confirmed that, indeed, the last bid in the hourly batch of bids becomes the winning bid rate for the power to be purchased from the winning bidder with lowest bid price, even if there are much lower bid rates submitted to WESM.

I suppose there is no honest procurement bidding scheme anywhere on earth where ***the highest bid price is declared the winning bid despite available lowest and most advantageous submitted bid.*** This utter lack of free-market competition—and sanity?—in touted WESM is simply outrageous and must be stopped. If true, only dishonest or incompetent government officials will tolerate this disgraceful bidding scheme.

While the normal power generation rate shown in Meralco bills is less than ₱6.00 per kWh, the WESM offer price cap was set at the atrociously high ₱62.00 per kWh in June 2006. Owing to the public outcry against the scandalously high power rates in 2013 that reached the Supreme Court, this ultra-high price cap for winning bid even during times of low demand was reduced to ₱32.00 per kWh in December 2013.

While the Department of Trade and Industry (DTI) runs after profiteering merchants who take advantage of supply shortfall during emergency periods, *WESM operators allow WESM bids at the foregoing allowable peak rate whenever there is a power supply shortfall brought about by scheduled and unscheduled power plant shutdowns.* This improper profiteering scheme is possible because the power generation industry is deregulated under EPIRA and unwisely freed from the Supreme Court-ruled 12% reasonable return on investment. Even then, WESM founders and operators should have exercised simple common sense and proper sense of balance—through setting competitively much lower WESM offer price cap close to ₱6.00 per kWh. Better still, there should be a separate price cap per type of power plant (hydro, geothermal, oil-fired, etc), each of which has a unique generation cost.

The WESM bidding system is evil, a free-market-competition hoax foisted upon blatantly deceived consumers. It is a mockery of the competitive bidding system and a scheme instituted by the government's Department of Energy and Energy Regulatory Commission that reflects badly on legal, economic, and financial experts in government—especially those in Malacañang, NEDA, DOJ, DOE, ERC, and Commission on Audit (COA). They appear blissfully ignorant of, or helpless against, consequently overpriced WESM electricity rate, which victimizes both the government and the paying public in their capacity as overcharged power consumers. The defective WESM bidding system was exposed by media in late 2013 to early 2014 and yet it seems it registered nothing on our highest executive and legislative government officials.

### **PROOF OF LACK OF TRUE COMPETITION IN WESM**

"In power, as in any other sector or industry, competition is what drives the economy to efficiency and improved consumer welfare, a fundamental principle taught in basic economics. Lack of it leads to excessive unearned profits accruing to a few at the expense of the many (that is, we consumers)...."<sup>87</sup>.

In the light of such plain and basic economic thought, it is shocking how past and present DOE and ERC officials could play the principal role in the formulation, approval, institution, and perpetuation of the WESM bidding scheme, which is simply absurd and devoid of competition.

In procurement, competitive bidding aims to award the purchase to the bidder who submitted the lowest bid price, which, all other things being equal, equates to the most advantageous bid. ***Thus, in the WESM procurement bidding system, there is clearly no competition for the needed lowest bid price—because it declares as winning bid the accepted highest bid—and the winning highest bid is applied to all power sold, even if there are much lower bids!***

Even if the winning highest bid price is offered for a small volume by a small power producer, it will be applied to all power sold—a senseless case of the tail wagging the dog and a fertile ground for price manipulation. How exalted DOE and ERC officials could approve and tolerate such an anti-market, anti-business, anti-poor, and anti-reason WESM procurement bidding system is astounding and puzzling. *Even Meralco's lawyer found it improper and indirectly admitted the impropriety before the Supreme Court.*

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<sup>87</sup> Cielito F. Habito, "Wanted: true competition in power," *Philippine Daily Inquirer*, January 21, 2014, p. A9.

## **Meralco's Own Lawyer Exposed Before the Supreme Court the Lack of Price-Lowering Competition in WESM**

*"(I)n the WESM, the sellers of electricity are not paid what they ask for; they are paid what the last accepted bidder asks for. (Their bids are arranged from lowest to highest, and the highest accepted price is what is paid by the consumers. So if the maximum bid of ₱62/kWh is the clearing price, think of the price spike for the consumers and the windfall profits for some power generators."*<sup>88</sup>

Economist Solita Monsod's revelation in her newspaper column of the lack of competition in WESM may not have evidentiary value before our courts, but it was corroborated, admitted, and exposed by Meralco's own lawyer during oral arguments before the Supreme Court, on the petition for a temporary restraining order (TRO) against Meralco's ₱4.15 per kWh rate increase, viz: ***"Senior Associate Justice Antonio Carpio repeatedly asked how many times Meralco had to buy at ₱62. (Meralco lawyer Victor Lazatin stressed no buyer can predict the price; given the mechanics, a buyer only states the quantity it needs and Meralco was a price taker. He further said the 'must offer' rule should cover only power not presold, and the price passed to consumers should be each generator's actual quote instead of the highest accepted price. This, he argued, would make quotes realistic, unlike an extreme zero or ₱62."***<sup>89</sup> Hence, even Meralco's own lawyer in effect declared that the WESM winning bid rate should be the actual lowest bid price, instead of the highest accepted price, an indirect admission that the ₱4.15 per kWh Meralco rate increase, corresponding to the WESM winning bid at the highest accepted price, is not right, because what is right is the submitted actual lowest bid price, the winner in true and fair competition.

### **Why Not Monthly Bidding in WESM?**

Instead of hourly WESM bidding, why not conduct monthly bidding, or asking each bidder to submit its offered supply for one month together with bid rate. Then, on a daily or hourly basis, tapping of supply will be based on the ranking of winning bidders from lowest to highest accepted bids and to the extent of each one's offered supply. (The mechanics can be studied and refined.) This will do away with the present anti-consumer hourly bidding system.

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<sup>88</sup> Solita Collas-Monsod, "Get Real: Who's responsible for power price spike?" *Philippine Daily Inquirer*, December 14, 2013, p. A12.

<sup>89</sup> Oscar Franklin Tan, "SC proving wrong place for Meralco case," *Philippine Daily Inquirer*, February 7, 2014, p. A12.

**COMPETITION WILL CEASE TO FUNCTION IN WESM  
ONCE THERE IS SHORTAGE IN POWER SUPPLY DURING  
SHUTDOWN OF SOME POWER PLANTS—AND IF THERE IS NO  
COMPETITION THEN THERE IS NO FREE MARKET, THEREFORE,  
REGULATION SHOULD APPLY DURING THAT TIME TO PREVENT  
REMAINING OPERATING POWER PLANTS FROM RAISING THEIR  
RATES EVEN WITHOUT INCURRING ANY ADDITIONAL COST**

Free-market deregulation of the privatized power generation industry under EPIRA is premised on the competition that will result. However, under textbook economics, perfect competition depends on the presence of certain indispensable requisites like, among other things, free choice on the part of both sellers and buyers, as well as the existence of enough number of sellers and buyers dealing with adequate supply, none of whom can influence the market. These two requisites are absent in WESM whenever some power plants are on regular or emergency shutdown and power supply is either deficient or just enough to meet total demand—because, as a basic necessity in the economy which consumers have to buy for as long as they can, even the last kilowatt of available electricity has to be purchased at the highest allowable rate to meet total demand. To illustrate, during the simultaneous shutdowns of some power plants in 2013, the normal power generation rate of less than ₱6.00 per kWh in WESM rocketed to the ₱62.00 per kWh allowable maximum bid. Power generators exploited this profiteering opportunity because Meralco would buy offered power supply regardless of price just to meet demand and avoid brownouts, which were embarrassing not only to Meralco but also to highest government officials.

Whenever there is a shortage in power supply in WESM, as was the case in 2013, there is no competition and it ceases to be a free market—because during that time WESM does not possess the requisites of competition in free market. For instance, it does not have enough sellers with abundant supply. Also, consumers have no free choice but to buy electricity because it is a basic necessity without alternative cheaper and suitable substitutes. Therefore, ***free-market pricing becomes fallacious under the situation***—but free-market economists are oblivious to it, so why follow them? It is plain common sense not to allow profiteering in WESM during times of short supply. ***It is up to elected political leaders to make the political decision to prohibit it as part of good governance and sound economics,*** similar to that being done by the Department of Trade and Industry (DTI). As reported in evening TV newscasts, DTI has been preventing unwarranted price increases in pan de sal, canned goods, and other products consumed by mass consumers, a public service started in the time of DTI Undersecretary Victorio Mario Dimagiba.