



June 23, 2020

Secretary ALFONSO G. CUSI
Department of Energy
Energy Center, Rizal Drive
Bonifacio Global City, Taguig 1632

Re: Updates on the CSP for 1,800 MW (net) COD 2024-2025

Dear Secretary Cusi:

I write to provide updates on Meralco's planned competitive selection process ("CSP") for 1,800 MW (net) new capacity COD 2024-2025 (the "2024-2025 New Capacity") approved by the Department of Energy ("DOE").

The Enhanced Community Quarantine and Modified Enhanced Community Quarantine imposed by the Government in Metropolitan Manila and the National Capital Region during the period from March 16 to May 31, 2020 to control the spread of COVID-19 infections substantially hampered our operations and this prevented us from commencing the implementation of the CSP for the 2024-2025 New Capacity as scheduled. Geo-political developments and the COVID-19 pandemic also caused unprecedented volatility in global fuel prices, particularly gas prices, and this has posed, and continues to pose, serious challenges to the fuel cost provisions approved by the DOE on March 25, 2020 for the Terms of Reference ("TOR") of the CSP for the 2024-2025 New Capacity.

Uncertainty in Fuel Price Movements

The tariff structure portion of the TOR states that the "Bidder shall provide a fuel price forecast for the four quarters beginning second quarter of 2020 in USD/MMBtu", which shall be used in the evaluation of the bid. However, the current environment has significantly increased uncertainty in international fuel prices and the situation continues to evolve.

As can be seen from the recent data of the World Bank and Japan Ministry of Economy, Trade and Industry ("METI"), prices of US natural gas based on the Henry Hub Index, Japan LNG spot, and Brent oil have fallen by unprecedented levels: 22%, 66%, and 53%, respectively, since the start of the year. Australian coal price also posted a 21% reduction in May 2020 after maintaining stability in the first quarter of the year.

	World Bank ^a			Japan METI ^b
	USD/Bbl	USD/MT	USD/MMBtu	USD/MMBtu
	Brent Crude	Australian Coal	Henry Hub	Japan LNG Spot
Dec 2019	65.85	66.18	2.24	6.40
Jan 2020	63.60	69.66	2.03	5.90
Feb 2020	55.00	67.64	1.92	3.40

Mar 2020	32.98	66.74	1.79	3.40
Apr 2020	23.34	58.55	1.74	2.40
May 2020	31.02	52.49	1.75	2.20
May 2020 vs. Dec 2019	-53%	-21%	-22%	-66%

Source:

^a World Bank Pink Sheet Data, <https://www.worldbank.org/en/research/commodity-markets>

^b Japan METI Spot LNG Price Statistics, <https://www.meti.go.jp/english/statistics/sho/slng/index.html>

There is consensus that international fuel prices will remain volatile in the short-term. Futures settlement prices as of June 12, 2020 show that the Henry Hub Index, Japan-Korea Marker for LNG spot transactions, and Global Coal Newcastle Index may fall further in the coming months before slowly bouncing back up towards the end of the year. For its part, the US Energy Information Administration in its June 2020 Short-Term Energy Outlook expects Brent oil prices to slightly pick up to an average of \$37.14/Bbl for June to December 2020.

	Henry Hub Index (USD/MMBtu) ^a	Japan-Korea Marker (USD/MMBtu) ^b	ICE GlobalCoal NEWC (USD/MT) ^c
Jul 2020	1.73	2.07	54.25
Aug 2020	1.82	2.28	
Sep 2020	1.87	2.50	
Oct 2020	1.96	2.90	57.12
Nov 2020	2.35	3.68	
Dec 2020	2.83	4.24	

Source:

^a CME Group, https://www.cmegroup.com/trading/energy/natural-gas/natural-gas_quotes_settlements_futures.html

^b CME Group, https://www.cmegroup.com/trading/energy/natural-gas/lng-japan-korea-marker-platts-swap_quotes_settlements_futures.html

^c GlobalCoal, <https://www.globalcoal.com/tools/icecoalfutures.cfm>

For the medium-term, the outlook for the next five years on coal and LNG prices has changed significantly over a period of six months, comparing the October 2019 and April 2020 Commodity Market Outlook of the World Bank. In the longer-term, however, fuel price forecasts are expected to return to late 2019 levels.

The current historic abnormally low international fuel prices and the lingering uncertainty in these fuel prices will distort the evaluation of the levelized cost of electricity (“LCOE”) for long-term power supply agreements (“PSAs”). For example, fuel that currently has historic unprecedented low prices will have an undue advantage over other fuels and CSP participants planning to use such abnormally lower-priced fuel will correspondingly submit abnormally low offers. However, with the expectation of increasing international fuel prices as the situation normalizes, consumers will be saddled with power prices that are much higher than what could have been procured under normal circumstances.

Bidders will also find it unfair to be asked to commit to a fuel price forecast now. Because current fuel prices are abnormally low, especially for those correlated to Brent oil, there is consensus expectation of price increases in the future; however, what remains uncertain is how much and how quickly such prices will recover. Consequently, some bidders may be constrained to submit higher-than-expected prices to

account for this uncertainty and to assure themselves full fuel cost pass-through during PSA implementation. Worse, some bidders may choose not to participate in the CSP given the current situation, thereby making the exercise less competitive, to the detriment of electricity consumers.

As provided in the TOR, during the implementation of the PSA, the fuel cost shall be the lower between the result of the DOE-prescribed formula and actual fuel costs. The Bidder's fuel price forecast (F_o) shall be adjusted using an adjustment factor based on the ratio of actual quarterly average fuel price of the immediate prior year (P_n) over the actual quarterly average fuel price for the four quarters beginning second quarter of 2020 (P_o).

Accordingly, to give some time for international fuel prices to stabilize, we respectfully recommend that the period covered by F_o and P_o be adjusted to start at the third quarter of 2022. This will help mitigate, if not prevent, "bill shocks" that may arise when the full pass-through of fuel prices takes effect from Year 11 onwards.

Adjustments in CSP Procedures for the "New Normal"

On the conduct of CSP activities, we note that the COVID-19 situation has also created difficulty in implementing CSP procedures that comply with Government and MERALCO requirements on community quarantine and DOE Department Circular No. DC2018-02-0003 ("CSP Circular").

As currently provided in the CSP Circular and MERALCO's bidding process, face-to-face interactions among the Third Party Bids and Awards Committee ("TPBAC"), CSP observers, and bidders are required during the following stages of the bidding process: (i) Pre-Bid Conference, (ii) Submission, Opening and Evaluation of Bids, and (iii) Contract Signing. Based on the assessment of MERALCO and the TPBAC, the Pre-Bid Conference and Opening/Evaluation of Bids cannot be completely done through video conferencing and will still require the TPBAC and its technical working group and legal counsel to gather in one venue. However, present constraints on travel and on the availability of venues to safely accommodate the expected number of attendees prevent the conduct of these CSP stages. Even with a downgrading of the prevailing General Community Quarantine to Modified Community Quarantine and eventually to "New Normal", prudence and safety dictate that the continued practice of physical distancing and avoidance of large congregations of persons in confined spaces have to be observed.

We, therefore, also recommend that the CSP activities for the 2024-2025 New Capacity resume starting October 1, 2020 to allow us to make adequate preparations for the conduct of CSP activities requiring face-to-face meetings, particularly with respect to the implementation and observance of all necessary health protocols in compliance with applicable Government and MERALCO COVID-19-related guidelines.

Thank you for your attention and kind consideration.

Yours sincerely,


RAY C. ESPINOSA
President and CEO

Cc: Undersecretary Jesus Cristino P. Posadas
Undersecretary Emmanuel P. Juaneza
Assistant Secretary Redentor E. Delola
Director Mario C. Marasigan
Ms. Maria Teresa Mendoza