

# AN OPEN LETTER TO PRES. GLORIA MACAPAGAL-ARROYO FROM OSCAR M. LOPEZ

Dear Mrs. President,

I am writing this open letter to you to express my full support to your desire to bring down power rates. In this regard, **I have proposed that EVAT be removed and the royalties of Malampaya gas be waived** or proceeds used to subsidize low income consumers and other preferred sectors such as export industries.

Allow me to explain my proposals as well as to clarify some basic issues you have brought up in relation to Meralco, such as high electricity rates and what can be done about these rates.

First of all, I would like to sketch a short historical account of the history of the power industry in this country and the Lopez involvement in this industry. The history of the power industry can be analyzed in terms of a swinging pendulum, from private power in the pre-martial law period, to public power during the martial law years. Today, that pendulum is swinging back once more in favor of private power, especially after the passage of the Electric Power Industry Reform Act of 2001, better known as the EPIRA law.

Established in 1903 by American investors, the Manila Electric Railroad and Light Company or Meralco quickly became the dominant power company in Luzon. By the outbreak of World War II (WW II), Meralco operated not only in Metro Manila but also in 15 outlying provincial areas, as far north as Dagupan City in President Ramos' province Pangasinan down to Naga City in Camarines Sur. It was only after WW II that Meralco relinquished its franchise operation in 45 municipalities in 10 provinces to concentrate in the Manila Metropolitan Area and its environs, which was undergoing a tremendous growth in commerce and industry.

But the big expansion of the Meralco system coincided with the transfer of its ownership from American to Filipino hands headed by my father, Eugenio Lopez, in 1961. If one can talk about a "Golden Age" for Meralco and private power, it was during the decade of the 1960's. Those years were an exciting and exhilarating period for the Philippine power sector. If I now seem to describe that era with vicarious recall, it is because I lived and worked in the middle of it all, as Senior Vice President of Meralco Securities Corp., better known today as First Philippine Holdings Corporation. Consider these factors. In 1961, Meralco had a total generating capacity of about 300,000 KW (kilowatts); by 1972, its generating capacity had increased 5-fold to 1,500,000 KW, all in the form of oil-fired thermal plants. Meralco was putting up one plant every 18 months to keep up with the tremendous demand for power in its franchise area. KWH (kilowatt-hour) sales went from 1,700 GWH (gigawatt-hour) in 1961 to 5,100 GWH in 1972, or an annual compounded growth rate of 10.6%. By 1972, Meralco's customer base had grown to 612,454 from just 368,925 in 1961. And today, Meralco's customers number more than 4 million. Such a massive drive to expand capacity had never been witnessed in Meralco's service area before.

Average cost of fuel oil during the 1960's was \$1.68/barrel, which translated to an average cost for all Meralco customers of 5.8 centavos per KWH during this 10-year period—very cheap power indeed for Meralco's customers. What was all the more impressive was that all this growth was financed without relying on government guarantees, but solely on Meralco's superior credit standing in both domestic and international bond markets.

The government and equipment suppliers of four major industrial countries—the U.S., Germany, Japan, and Belgium—came to accept Meralco's Mortgage Trust Indenture (MTI) and bonds as sole collateral for equipment loans. Meralco engineers likewise waged an unrelenting battle against system losses. In 1961, these losses amounted to 12.56% but in 1971 this was reduced to 7.95%.

On the other hand, let us look at the record of public power at this time. National Power Corp. (NPC) was established in 1937, and it was mandated to develop the country's hydro-power resources.

**From 1961-72, of the eight major power projects programmed for completion in Luzon with a total capacity of 728 MW, only two projects with a combined capacity of 287 MW were completed by NPC.**

It was quite obvious that **had Meralco depended on NPC as the main source of its power supply, Meralco would have invariably suffered prolonged periods of brownouts.** In fact, the Meralco franchise area did suffer from rotating brownouts during the years 1956-59, as a result of the delays in the completion of the Ambuklao and Binga hydro plants.

Like all good things, this "Golden Age" of Meralco and private power in general came to an end by the early 1970's, as a consequence of the serious trade and balance payment deficits of the country.

More importantly, in 1971, action taken by the Organization of Petroleum Exporting Countries or OPEC, resulted in several dramatic increases in the international prices of petroleum products. From a level of \$1.68/barrel in the 1960's Meralco paid \$4.68/barrel in 1973, \$11.50/barrel in 1976 and \$34/barrel in 1981.

These factors—exchange rate, inflation and fuel prices, sounded the death knell of the old era of private entrepreneurial power. The pendulum would now swing in the direction of public power.

Henceforth, there would be no inexpensive new power generating capacity. The surge of peso-dollar exchange rates and local interest rates, meant that large, foreign currency denominated investments with long payback would fall increasingly out of reach of the private sector. Government would now begin to assume the leading role in major infrastructural investments such as in power, steel and transportation, etc.

Hand-in-hand with the economic crisis came the political crisis. On Sept. 21, 1972, President Marcos declared Martial Law. He padlocked Congress, rounded up and imprisoned left wing leaders, radical students, including his principal political enemies and media critics—closed down all opposition media. My father, as president of Meralco, was from 1970 onwards at political odds with Marcos as our family newspaper, the *Manila Chronicle*, became very critical of graft and corruption of the Marcos regime.

Thus, the full force of the new dictatorship was turned towards divesting the Lopez family of its control of Meralco. Meralco was placed under the control of the 51st Engineering Brigade of the Philippine Army, in accordance with his Letter of Instruction No. 2 ordering the Secretary of National Defense to take over management and control of all public utilities.

The rest is current history, about the downfall of Marcos and how the Lopezes got back Meralco during President Aquino's regime.

## Why are Philippine power rates so high vis-à-vis our Asian neighbors?

But we must ask ourselves the question—from having one of the lowest power rates in the world in the late 60's, today, the country finds itself struggling with one of the highest power rates in the region, if not the world? So what happened? There are numerous reasons, but let me zero in on a few of the most important.

**Firstly, our country's drive to develop indigenous and alternative sources of power from the 1970's until the present paled immensely in comparison to our Asian neighbors.** It's major obstacle that holds us back from competing effectively with neighboring Asian countries for manufacturing jobs. It's good to keep in mind that the price of electricity is ruled predominantly by the cost of fuels used for power generation.

A snapshot of how countries compared in 2003 with regards to fuels used electricity generation reveals how far ahead most of our Asian neighbors are in the development of indigenous sources of energy for their power sector.

Even today, though our indigenous fuels in the mix seem to have improved to almost 70%, we still haven't narrowed the gap in our electricity prices vis-à-vis our neighbors and our indigenous fuels in fact appear costly. Why?

This brings me to my second point. It's a sad fact that despite the rhetoric heaped on encouraging the use of indigenous fuels in the country we continue to impose heavy taxes and royalties on indigenous fuels, like natural gas and geothermal steam, which together produce more than 47% of our electricity needs. **Indigenous fuels are made artificially more expensive than imported ones because of this tax and royalty burden.** Take the case of our country's own natural gas from Camago-Malampaya. The power plants using clean natural gas from our own shores are made to look more expensive relative to power plants burning imported coal because of these taxes and royalties. This treatment is sad and ironic because in neighboring countries like Thailand and Malaysia, natural gas used domestically is even subsidized, thereby encouraging more incentive to use and find more of this valuable resource. By our own DOE's reckoning, we have potentially 10 more Camago-Malampayas and another 10,000 MW (megawatts) of geothermal potential out there. But, if present policies continue, our power industry will be discouraged to build more power plants that burn either natural gas or geothermal steam, and it will be less likely that much of the untapped reserves of natural gas and geothermal steam will be brought to market much sooner.

**Another major reason is that the selling price of Camago-Malampaya gas is indexed to crude oil prices.** When we signed with Shell and Occidental Petroleum back in 1998, crude oil prices were only at US\$15/barrel. Today the oil price has gone up to more than 8 times. Yet, I do not think that the costs of producing Malampaya have increased by anywhere close to the same multiples. So I invite you to draw your own conclusions as to the size of that windfall being reaped by the Camago-Malampaya gas sellers, especially since these gas sellers have completely paid off the Malampaya project cost as of last year. This is an area where the President can exert her influence to have the gas sellers reduce their price of natural gas in order to benefit the electricity consumers in this country. Alternatively, government can impose a windfall profit tax and use the proceeds to subsidize low income consumers.

For the 1st quarter of 2008, First Gas' selling price of P4.15/KWH to Meralco, fully P2.93/KWH (70%) is the cost of gas and approximately P1.61/KWH out of that goes to government in the form of royalties. On top of all that the consumer still pays P0.80 per kilowatt hour in the form of a 12% EVAT for power. **If you add up the royalties and 12% EVAT, you will get an amount of P2.40/KWH which may be passed on as a welcome reduction in the electricity bills of consumers.**

But under present circumstances, even if we use more indigenous fuels in our power generation mix today, that reality doesn't lead to lower electricity prices and is not likely to spur more development of indigenous energy until these structural disincentives are corrected.

Over time, we must reduce our reliance on imported fuels if we want to gain a competitive edge on power costs with respect to our Asian neighbors.

The country's efforts will go a long way if government paid closer attention to removing the taxes and royalties that gravely penalize Filipino consumers in using their own indigenous fuels. Much of these come from old antiquated Marcos-era Presidential Decrees that no longer fit the times and although they provide revenues for government, they serve to make already expensive power even more so.

I will answer the basic question we posed with another question. **If we clamor to have cheaper power, why do we tax it so heavily in the first place?**

Your Excellency, if you want to give cheaper electricity rates to consumers, you must remove these EVAT taxes and royalties on natural gas.

OSCAR M. LOPEZ  
Chairman of First Philippine Holdings Corporation  
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