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Promoting competition and regulatory reforms in franchising electricity distribution

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Promoting Competition and Regulatory Reforms in Franchising Electricity Distribution

by

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Promoting Competition and Regulatory Reforms in Franchising Electricity Distribution

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Abstract

This paper examines the implications of renewing Meralco's electricity distribution franchise, which was recently extended for another 25 years. Several unresolved competition and regulatory issues challenge the alignment of this extension with the Electric Power Industry Reform Act (EPIRA) of 2001. Key concerns include Meralco's dominant market position, cross-ownership with generation companies, potential franchise creep, and its influence in the retail market. The paper advocates for structural reforms such as competitive franchise auctions, stricter cross-ownership limitations, and the possible division of Meralco's service areas to promote market efficiency and consumer welfare. It also proposes granting the Energy Regulatory Commission (ERC) the authority to oversee franchise bidding and to enforce more rigorous monitoring of market behavior. The findings emphasize that automatic renewal without reforms risks entrenching monopolistic practices and foregoing opportunities for improving transparency, competition, and efficiency in the electricity distribution sector.

JEL Codes: L94; L51; L41

Keywords: Electricity Distribution, Franchise Regulation, Competition Policy

Promoting Competition and Regulatory Reforms in Franchising Electricity Distribution

1. Introduction

Meralco's current franchise is set to expire in 2028, and on April 11, 2025, the President signed into law the measure extending the franchise for an additional 25 years. This paper focuses on several regulatory and competition issues that are unresolved at this juncture, necessitating policy interventions. Resolving these issues is critical to help ensure that the franchise renewal aligns with the objectives of Republic Act No. 91306, known as the Electric Power Industry Reform Act (EPIRA) of 2001. The latter envisions the delivery of quality, reliable, secure, and affordable electricity services to end users, which remains only partially realized after more than two decades of EPIRA's implementation.

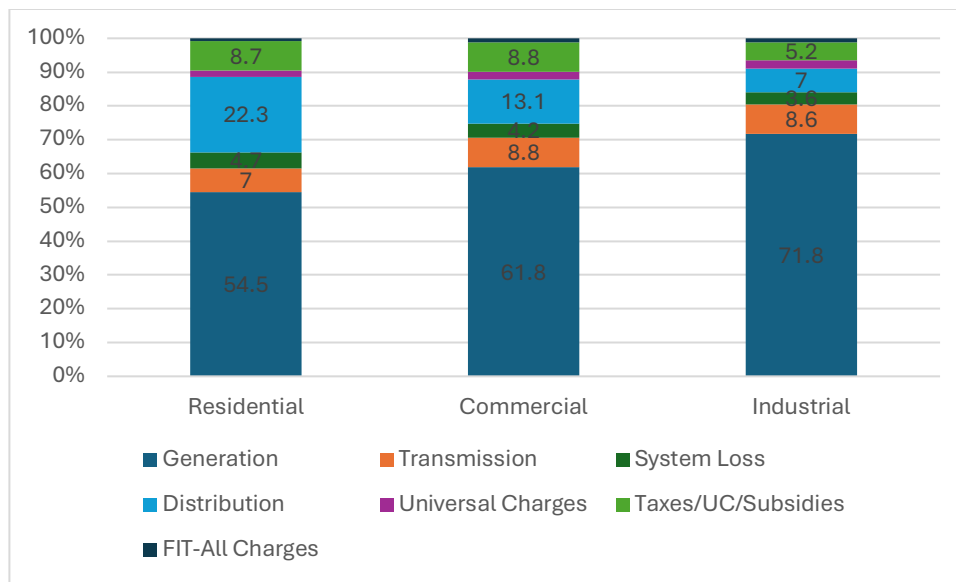
The scale and strategic importance of Meralco's operations amplify the criticality of ensuring that its franchise renewal supports broader public interest objectives. Given its coverage of nearly 10,000 square kilometers, its service to approximately half of the country's GDP, and its control over a significant share of the national electricity demand, Meralco's role in the Philippine economy underscores the necessity of adopting a rigorous, forward-looking regulatory framework.

The rest of the paper is structured as follows: Section 2 outlines critical competition and regulatory issues, while Section 3 proposes a set of policy recommendations to address these concerns.

2. Competition and Regulatory Issues Bearing on Meralco

Figure 1 illustrates that generation and distribution charges constitute over 70% of the total Meralco bill. Given that obstacles to competition can result in persistently high electricity prices, this section examines the potential competition issues that Meralco faces and their implications for consumer welfare.

Figure 1. Meralco Unbundled Power Rates



Source: DOE (2023) - 40th EPIRA Implementation Status Report

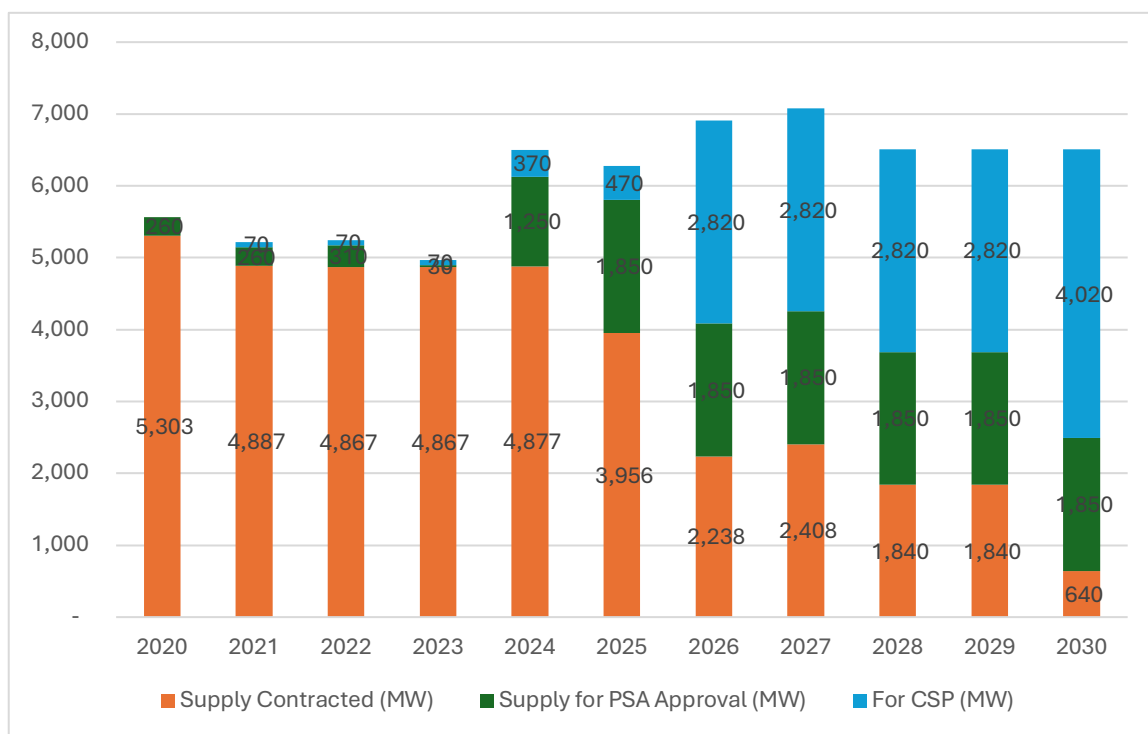
Electricity demand has been described as price inelastic¹, and under the current pricing framework, the generation charge operates as a pass-through cost. Within this context, distribution utilities (DUs) have limited incentives to lower the generation charge component. Consequently, it is essential for regulatory authorities to ensure that DUs procure power at the least possible cost to safeguard consumer welfare, given the absence of inherent incentives for DUs to reduce prices. Assessing price elasticities is crucial for DUs. Accurate demand elasticity estimates help utilities design effective expansion plans, optimize resource allocation, and align their operations with consumer behavior and evolving market conditions. This understanding is particularly relevant in transitioning toward more responsive and efficient energy systems.

Several competition-related issues affect the generation charge. Figure 2 indicates that Meralco procures electricity through Power Supply Agreements (PSAs) with various generation companies. In 2022, Meralco's PSA partners included First Gen Power Corporation (FGPC), which operates the Sta. Rita natural gas-fired plant; South Premiere Power Corporation (SPPC), which operates the Ilijan natural gas-fired plant; and the Sual coal-fired plant. Additionally, San Buenaventura Power Ltd. is operated by Meralco Power Generation Corporation (MGen), a wholly

¹ Santos, A. (2021) "Forecasting residential electricity demand in the Philippines using an error correction model". *Philippine Review of Economics* 57(1): 121-151

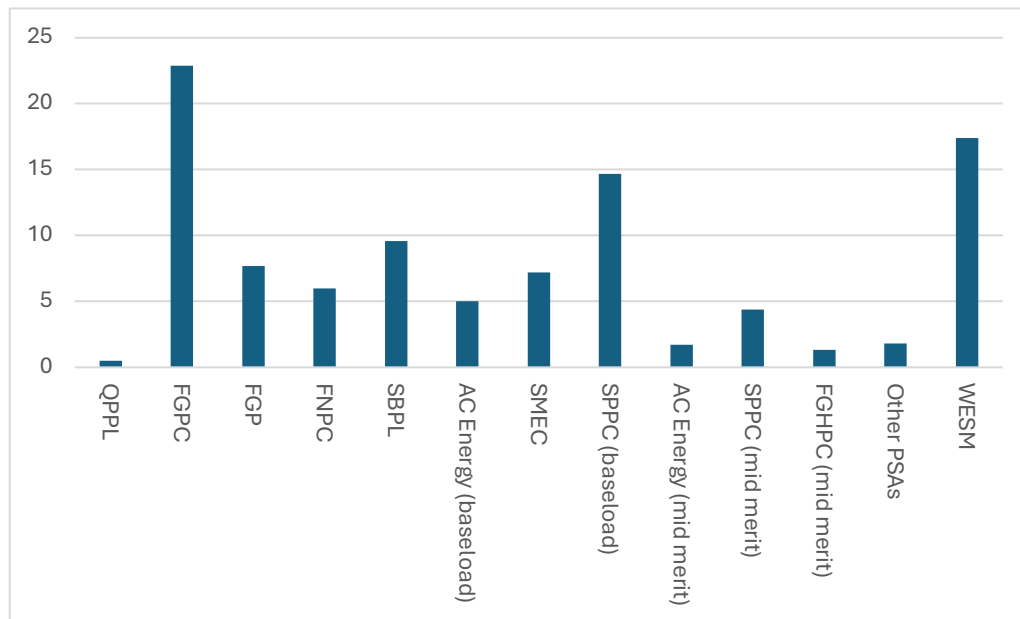
owned subsidiary of Meralco (see Figure 3). Although Section 26 of the EPIRA does not explicitly prohibit Meralco from owning generation assets, and Section 45 permits Meralco to source up to fifty percent (50%) of its total demand from affiliated generation companies through bilateral supply contracts, these arrangements raise competition concerns. Cross-ownership between distribution utilities and generation companies creates incentives for collusion, potentially undermining market competition and consumer welfare. Thus, the current cross-ownership arrangements between Meralco and its affiliated generation companies warrant re-assessment to ensure a more competitive and transparent electricity market.

Figure 2. Supply Profile of Meralco



Source: DOE Distribution Development Plan 2021-2030

Figure 3. Sources of Meralco Power Supply Requirement as of April 2022



Source: DOE (2023) - 40th EPIRA Implementation Status Report

To address potential anti-competitive behavior in the implementation of Power Supply Agreements (PSAs), the Department of Energy (DOE) requires that power suppliers be selected through a Competitive Selection Process (CSP). Currently, this mandate is outlined in DOE Department Circular No. DC2023-06-0021, titled *“Prescribing the Policy of the Mandatory Conduct of the Competitive Selection Process by the Distribution Utilities for the Procurement of Power Supply for their Captive Market”* and the Energy Regulatory Commission (ERC)’s CSP guidelines through Resolution No. 16, Series of 2023, titled *“Implementing Guidelines for the Procurement, Execution, and Evaluation of Power Supply Agreements Entered into by Distribution Utilities for the Supply of Electricity to their Captive Market”*. These policies aim to promote transparency, competition, and fairness in the procurement process, ultimately protecting the interests of consumers.

While the objectives of the CSP are commendable, it is reasonable to believe that Meralco's dominant position in the power sector may give rise to unintended adverse outcomes. First, Meralco's sheer size could influence the outcomes of the CSP process, as only large generation companies with substantial financial capacity and scale may be able to secure PSAs with Meralco. This dynamic may exclude smaller players, even if they could provide power at lower costs. Entry

into the electricity generation market often depends on securing bilateral contracts to obtain financing, and given Meralco's extensive customer base, new entrants are more likely to succeed by becoming one of its suppliers. Second, the investment, operation, and financing of power generation companies may become overly reliant on securing PSAs with Meralco. This dependency arises because dealing with Meralco as a single, large buyer is often more economical than negotiating separately with smaller DUs, which may lack the same market influence or financial appeal.²

Meralco has control over the dispatch of its contracted capacities, such as prioritizing baseload generation over mid-merit generation. Although these capacities are typically offered at a price of PhP 0, baseload plants can still offer higher prices and be dispatched if there is limited baseload capacity in the market. This ability to influence the dispatch process could result in market distortions, potentially reducing competition and affecting overall electricity pricing.

Meralco has recently entered into joint ventures with two of the largest generation companies in the industry, San Miguel Corporation and Aboitiz Power Corporation.³ These partnerships, combined with the outcomes of recent CSPs where these companies secured supply agreements with Meralco, have established significant linkages between Meralco and these major players. Such linkages may influence Meralco's business incentives, potentially affecting its dealings with other generation companies. This development further amplifies the already concentrated nature of the power market, a situation partly attributable to Meralco's substantial size and financial strength.

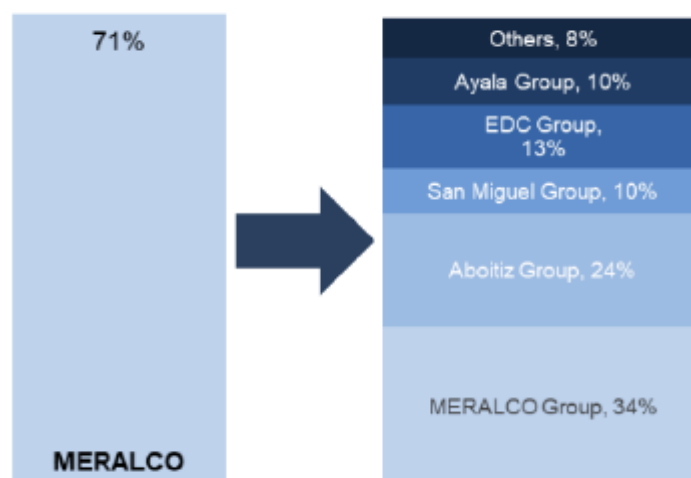
In the distribution and retail sectors, competition concerns also need to be addressed. As shown in Figure 4, 71% of contestable customers—those with a monthly average peak demand of at least 500 kW—are located within Meralco's franchise area. Of these customers, more than one-third (34%) are served by Meralco's retail arm, MPower. This cross-ownership raises concerns about the potential for Meralco to leverage its dominant position in distribution to unfairly dominate the retail market for contestable customers. Regulatory measures are essential to prevent

² See, for instance, the case of QPPL's coal plant where viability is seen to depend on a PSA with Meralco: <https://asian-power.com/ipp/exclusive/phl-power-plant-seeks-10-year-psa-supply-deal-nears-end>

³ <https://mb.com.ph/2024/3/2/meralco-subsidiary-corners-majority-stake-in-san-miguel-s-3-3-b-lng-project>

any abuse of this market power and to ensure a level playing field in the retail electricity sector.

Figure 4. Share in Contestable Customers' Energy Consumption by Supplier within Meralco Franchise Area, 2023-Q4



Source: PEMC (2023) - Retail Market Assessment Report for 4th Quarter of 2023

Another significant issue is the potential "franchise creep" of Meralco into other jurisdictions. Table 1 highlights Meralco's subsidiaries engaged in power distribution, while Figure 5 illustrates Meralco's shareholding structure as of 2021, showing its interests in various distribution utilities across different areas.

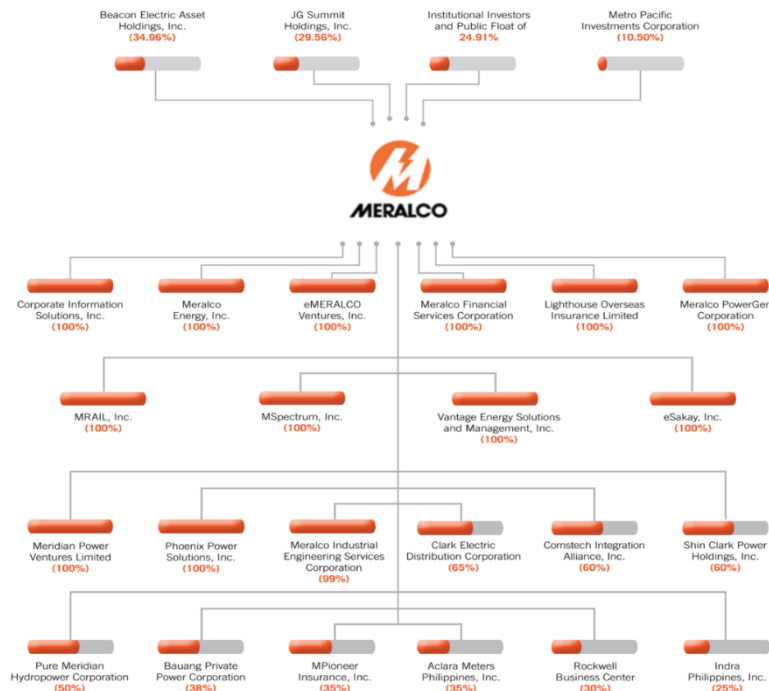
Table 1. Meralco Subsidiaries engaged in Power Distribution

Subsidiary	Distribution Area	Principal Business Activity	Nature of Ownership	Percentage of Ownership
Clark Electric	Clark Freeport Zone	Power Distribution	direct	65
Comstech	Franchise Area of PELCO II, and Cavite Economic Zone	Power Distribution	direct	60
Shin Clark Power	New Clark City	Management of Power Distribution	indirect	54

Source: Meralco 2023 Financial Statement

Figure 5. Meralco Shareholding Structure

Source: Meralco Website (2024)⁴



The complete list of the Public Ownership Report of Meralco as at December 31, 2021 was disclosed to the SEC, PSE, and PDEx on January 13, 2022, where approximately 75.09% of Meralco's shares are held by principal and strategic shareholders, and the remaining 24.91% shareholdings are held by directors, officers, employees, the government, other corporations, and other individuals. Meralco has a straightforward structure of alliance among its affiliates, and joint ventures. There is no pyramid shareholding structure within the group. Details of holding companies, subsidiaries, and other related companies are disclosed in the map showing relationships among the companies within the group.

While the operation of multiple franchises by Meralco, either through joint management or part ownership, could yield efficiency gains, it also raises critical concerns about the expansion of Meralco's already substantial market share in power distribution.

Another issue is that Meralco may selectively expand into areas with lucrative customer bases, leaving less profitable regions underserved. This selective approach could undermine the viability of electric cooperatives tasked with providing power to less profitable or more rural areas.⁵ Finally, Meralco's expansion into additional franchise areas could entrench its dominant market position, granting it competitive advantages that could hinder fair competition, particularly in bilateral contracting with generation companies. These dynamics warrant careful regulatory oversight to ensure balanced growth and equitable service delivery across jurisdictions.

⁴ Link: <https://company.meralco.com.ph/corporate-profile/meralco-shareholding-structure>

⁵ A recent case of ILECO vs MORE in Iloilo illustrates the possibility that such carving out of customers may result in higher rates due to reduction of the billing determinant (the basis for the computation of the rate). See <https://www.bworldonline.com/corporate/2022/01/21/424898/mores-expansion-seen-to-hike-power-prices-in-iloilo-areas/>

3. Retail Competition and Regulatory Reforms in Franchising Electricity

3.1 Franchise Bidding

Globally, the Philippines is *sui generis* in requiring a legislative franchise for public utilities, including power distribution (Table 2). While most jurisdictions no longer require legislative franchises, companies are still subject to licensing and regulatory oversight by the relevant regulatory bodies.

Table 2. Power Distribution Utilities' Franchise or License in Selected Jurisdictions

Country	Are legislative franchises required for public utilities in this country?	Are legislative franchises required for power distribution utilities in this country?	Who grants the franchise/license to operate for power distribution utilities? Who regulates?
United States	No. Legislative franchise is different per state. It is more common at the local level than state level.	No. No longer necessary but public utility commissions and regulatory bodies oversee the operations of DUs.	<ul style="list-style-type: none"> Local government bodies provide the franchises. State-level public utility commissions and regulatory bodies oversee the operations. In the case of California, California Public Utilities Commission (CPUC) issues a license to operate.
Australia	No. Legislative franchises are not required. They typically operate under licenses or certificates issued by relevant government agencies.	No. Legislative franchises are not required. They typically operate under licenses or certificates issued by relevant government agencies.	Agencies that issue licenses to operate <ul style="list-style-type: none"> Australian Energy Regulator (AER) for Victoria, South Australia, Tasmania, and New South Wales Queensland Competition Authority (QCA) for Queensland Energy Policy Western Australia (EPWA) for Western Australia
Singapore	No. The regulation of public utilities falls under the purview of government bodies, such as the Energy Market Authority (EMA) for electricity and gas, the Public Utilities Board (PUB) for water supply and wastewater management, and the Land Transport Authority (LTA) for	No. The EMA is a statutory board under the Ministry of Trade and Industry (MTI) of Singapore. It functions as the main regulatory body for the Singaporean energy sector, including issuing licenses for electricity generation, transmission, and distribution, overseeing the electricity market and promoting competition in	<ul style="list-style-type: none"> Singapore Power Group (SP Group) is the main electricity distribution company in Singapore, and it is majority-owned by Temasek Holdings, which is a Singaporean government-owned investment company. EMA is the regulator

	public transportation, including buses and train	the sector	
Philippines	Yes. The authority to issue franchises to public utilities is vested in Congress by the 1987 Constitution of the Republic of the Philippines.	Yes. RA 9136 or the EPIRA gives the Congress the power to grant franchises in the transmission and distribution sectors of the power industry.	<ul style="list-style-type: none"> · Congress (House of Representatives and Senate) gives the franchise. · Energy Regulatory Commission (ERC) oversees.
Thailand	No information	No. The primary authority responsible for issuing licenses to operate for power distribution utilities is the Energy Regulatory Commission (ERC).	<p>The primary power distribution utilities in Thailand are owned by the government. The two main players are government-controlled entities:</p> <ul style="list-style-type: none"> · Metropolitan Electricity Authority (MEA): Responsible for electricity distribution in Bangkok, Nonthaburi, and Samutprakarn provinces. · Provincial Electricity Authority (PEA): Handles distribution for the rest of the country.
Vietnam	No information	No. Power distribution utilities in Vietnam must obtain licenses from the Electricity Regulatory Authority of Vietnam (ERAV) to operate legally.	<ul style="list-style-type: none"> · Power distribution utilities in Vietnam are primarily owned by the government. Vietnam Electricity (EVN), a state-owned enterprise, dominates the Vietnamese power sector. · ERAV oversees the operations.
Indonesia	No information.	No. Power distribution utilities in Indonesia must obtain licenses from the Minister of Energy and Mineral Resources (MEMR) to operate legally.	<p>Depending on the specific jurisdiction, the relevant authority will grant the final license to operate. This could be:</p> <ul style="list-style-type: none"> · Minister of Energy and Mineral Resources: For licenses concerning areas with a national impact. · Provincial Administration: For licenses pertaining to a specific province. MEMR is also the regulator.

Our primary policy recommendation is to enhance competition in electricity distribution by implementing a franchise auction system. Franchise bidding addresses the issue of natural monopolies by substituting “competition *in* the market” with “competition *for* the market”.

We propose a structured reform of the franchise bidding process to enhance competition,

consumer welfare, and efficiency in the distribution utility (DU) sector. Franchise bidding involves the government awarding the exclusive right of providing a specified level of service to a private DU, with end-users paying for the service. The government grants monopoly rights to the winning bidder for a fixed term, typically 25 years. Regulation in this context aims to address the natural monopoly inherent in utility distribution. A competitive franchise bidding process, where rival bidders pre-qualified by the ERC compete to deliver services at the lowest cost, can generate significant economic benefits. Such bidding drives service costs toward the minimum average cost of provision, increasing consumer welfare by redistributing excess producer surplus. This competitive mechanism also reduces inefficiencies associated with monopolistic practices.

To institutionalize these reforms, we recommend authorizing the ERC to certify and pre-qualify private DUs eligible to bid for franchise areas. The ERC's regulatory powers under the EPIRA and its access to critical data on distribution costs (DC) and weighted distribution costs (DWC) position it as a key player in facilitating a competitive auction process. By actively participating in the auction, the ERC can ensure compliance with technical and regulatory requirements and foster meaningful competition.

Moreover, Congress's role in granting monopoly rights through a legislative franchise increases transaction costs and may conflict with the law's objective to enhance efficiency. Institutionalizing an auction process, with ERC oversight, would streamline franchise allocation, minimize inefficiencies, and maximize consumer welfare. The automatic renewal of Meralco's franchise upon its expiration in 2028, without a competitive auction, would forgo these potential benefits. Thus, we recommend that the ERC be granted the authority to conduct franchise auctions, ensuring that competition lies at the heart of the allocation process. A well-designed auction mechanism would minimize excess producer surplus, generate significant government revenue, and deliver substantial benefits to consumers, creating a more competitive and efficient electricity distribution sector.

Which DUs might be potential competitors in bidding for the Meralco franchise? We compared reliability indicators with the cost of residential and commercial rates of different distribution utilities, especially private DUs and Electric Cooperatives (ECs) that exhibit demand profiles comparable to that of Meralco. The lower left quadrants of Figures 6a and 6b show the

DUs/ECs demonstrating comparable system efficiencies and pricing for residential and commercial consumers to those of Meralco.

Figure 6a. Scatterplot of DUs based on SAIFI and Residential Price, 2023

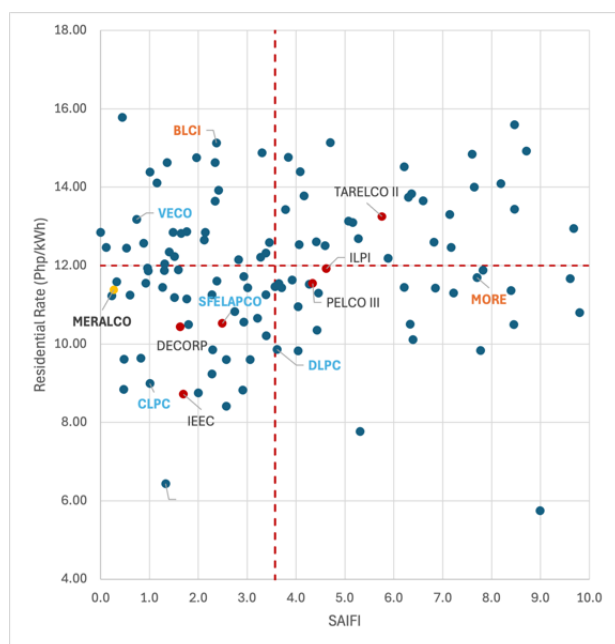
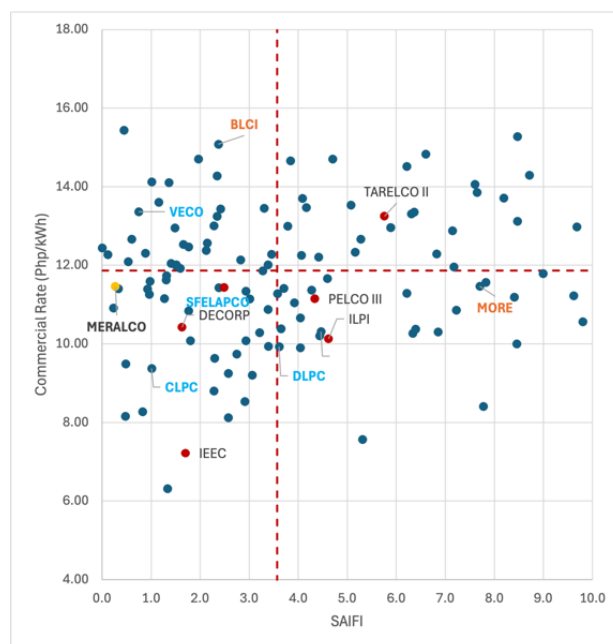


Figure 6b. Scatterplot of DUs based on SAIFI and Commercial Price, 2023



Note:

Razon Group: MORE, BLCI (in orange label)

Aboitiz Group: VECO, SFELAPCO, CLPC, DLPC (in light blue label)

3.2 Splitting Meralco's franchise area

Given the size of Meralco's franchise, it may be feasible to split the area into multiple franchise zones. Table 3 shows that several districts in the National Capital Region (NCR) exhibit electricity spending levels comparable to those of the provinces with the highest expenditures.⁶ This suggests that splitting Meralco's franchise area could sustain a profitable market for multiple firms operating in different zones. The optimal size of each franchise area, however, should align with the current engineering setup of facilities and infrastructure.

Dividing the franchise area and awarding each zone through a competitive auction could

⁶ While expenditures are determined by both price and quantity, it is not possible to get quantity from available data. While Meralco's prices may be higher than some of the private DUs, the spending numbers is indicative of the size of the residential electricity market.

yield several advantages. First, the firms awarded these zones can serve as performance benchmarks for one another. Comparative data on pricing, service quality, and cost-effectiveness could be used to assess and improve the efficiency of franchise holders. Second, splitting the franchise area can help mitigate market power by introducing multiple firms that can compete, for example, in offering Competitive Selection Process (CSP) agreements to generation companies. Of course, this assumes that the firms awarded the franchise do not have substantial cross ownership in large generation assets (see next subsection). Lastly, managing smaller franchise areas may enable firms to focus their resources more effectively, leading to improved service quality and enhanced operational efficiency.

Table 3. Top Provinces in Terms of Total Electricity Expenditures and Average Electricity Spending per Household in 2018

	Total Electricity Expenditures	Average Electricity Spending per Household
NCR-2nd Dist.	22,244,166,816	21,386
NCR-4th Dist.	21,473,715,300	19,267
Cavite	14,371,212,156	14,489
Laguna	12,050,896,770	14,016
Rizal	10,961,452,854	15,445
Cebu	10,842,528,516	9,160
Bulacan	10,646,976,966	13,144
Pampanga	10,158,844,716	15,433
NCR-3rd Dist.	9,854,961,660	14,204
City of Manila	8,516,841,534	18,280

Source of basic data: 2018 Family Income and Expenditure Survey (FIES)

Notes: NCR-2nd Dist (Mandaluyong, Marikina, Pasig, Quezon City, San Juan); NCR-3rd Dist (Caloocan, Malabon, Navotas, Valenzuela); NCR-4th Dist (Las Pinas, Makati, Muntinlupa, Paranaque, Pasay, Taguig, Pateros)

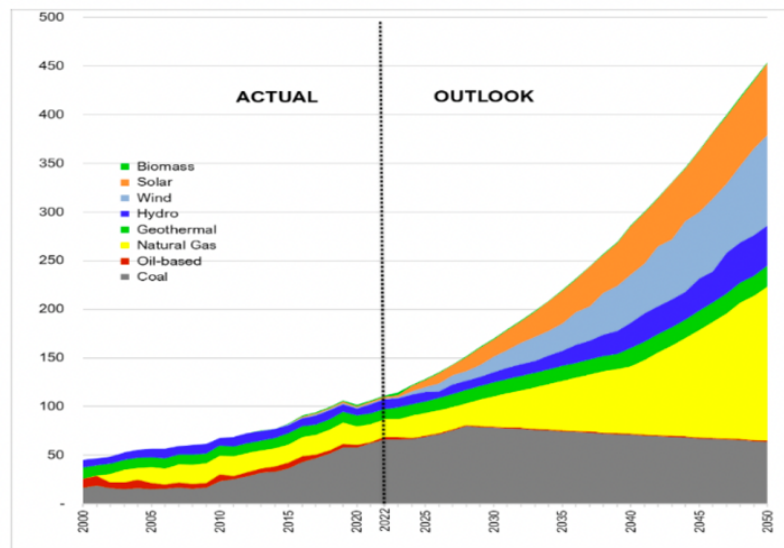
3.3 Cross-ownership and affiliate sourcing on CSPs

The provisions on cross-ownership in the EPIRA are relatively limited. At present, cross-ownership is only explicitly prohibited between the transmission company and any entity in the generation or distribution sectors. However, DUs are still permitted to hold interests in generation companies. To promote fair competition and prevent conflicts of interest, it is critical that EPIRA address this issue by ensuring a complete separation of ownership across the generation, transmission, and distribution segments of the electricity market.

Amendments to EPIRA could include an outright prohibition on cross-ownership or a mandate requiring companies operating across multiple segments to divest their interests in one segment. At a minimum, the Energy Regulatory Commission (ERC) should require such companies to establish legally distinct entities for their generation and distribution operations, with separate financial accounts and governance structures. Under Section 36 of R.A. 9136 (the Electric Power Industry Reform Act) and Rule 10, Section 3(b) of its Implementing Rules and Regulations (IRR), the ERC currently mandates that participants in the electric power industry structurally and functionally unbundle their business activities. These activities include power generation, transmission, distribution, and supply, with the submission of a Business Separation and Unbundling Plan (BSUP) being a key requirement. However, a critical issue lies in how the implementation of these BSUPs is monitored. Effective enforcement hinges on ensuring that mechanisms are in place to detect and address non-compliance. Without rigorous oversight, the objectives of unbundling may not be fully realized.

To address the limitations of cross-ownership provisions, Section 45 of EPIRA imposes a 50% cap on the total demand that a DU can source from bilateral power supply contracts with affiliated generation companies. However, this constraint remains relatively soft for several reasons. First, given Meralco's scale, 50% of its total demand represents a significant volume, allowing the utility to own and source from multiple generation plants without exceeding the cap. Second, as electricity demand continues to grow over time (Figure 7), and given Meralco's commanding 40% share of total electricity demand in the Philippines, the 50% cap still permits an expansion of Meralco's generation portfolio. Consequently, stricter measures may be necessary to effectively address these concerns.

Figure 7. Gross Generation Output by Fuel (TWh), 2000-2050



Source: Philippine Energy Plan 2023-2050

There are several strategies to limit Meralco's generation portfolio and its affiliate sourcing from bilateral contracts. First, succeeding franchise grants could stipulate that Meralco's generation portfolio growth should be capped at a rate below the projected growth in electricity demand. This approach would ensure that the expansion of Meralco's generation capacity remains controlled over time. Second, the affiliate sourcing threshold could be explicitly reduced in the new franchise agreement through a staggered mechanism—for instance, decreasing the cap by five percentage points every five years. This would result in a reduced affiliate sourcing cap of 25% by the end of a 25-year franchise period.

Additionally, it is essential to clarify the definition of controlling interest. The ERC's Rules define controlling stockholders as "stockholders, natural or juridical, singly or collectively with related interests, owning more than **25% of the voting shares** of a distribution utility" [emphasis ours].⁷ However, complex ownership structures can make it challenging to enforce EPIRA's provisions on dispersal of shareholdings in distribution utilities. Addressing this complexity is critical to preventing high concentration ratios, which pose a risk of market dominance and abuse while also exacerbating inequality in income and wealth distribution. To tackle this, the Securities and Exchange Commission (SEC) should be empowered to conduct comprehensive reviews of Meralco's corporate profits and recurrent income-dividend policies. With the assistance of

⁷ <https://elibrary.judiciary.gov.ph/thebookshelf/showdocs/10/43656>

professional accountants and auditors, the SEC can assess pre- and post-tax corporate income to determine whether Meralco's returns align with the permissible levels under regulatory frameworks, ensuring its investments remain viable while preventing excessive profits.

Reforms in cross-ownership and affiliate sourcing should also be complemented by antitrust and competition laws. The Philippine Competition Commission (PCC) must maintain vigilance against mergers, acquisitions, and anti-competitive practices within the electricity sector. Moreover, it can exercise its authority by requiring Meralco to comply with ex ante significant market power (SMP) obligations that it may develop. PCC should develop the SMP framework, guidelines and principles for the energy sector (including distribution). By strengthening the PCC's role in enforcing EPIRA's provisions against cross-ownership, the risks associated with excessive market power and potential abuse can be effectively mitigated. Integrating the PCC into broader institutional reforms would reinforce its mandate to deter anti-competitive behavior that undermines EPIRA's goal of fostering equitable and efficient energy markets.

Lastly, these considerations underscore the need to delegate the authority to grant franchises from Congress to the ERC. Franchise-related tasks require a high degree of technical expertise, ongoing monitoring, and the capacity to analyze large-scale data. Leveraging tools such as big data analytics and machine learning estimation can enhance the ERC's ability to regulate and oversee the electricity market effectively. This transition would align the franchise granting process with the technical and regulatory demands of the modern energy sector.

3.4 Retail Supply

One of the key objectives of the EPIRA is to facilitate open access and promote retail competition in the electricity sector. However, as noted in Section 2, Meralco's significant involvement in the retail supply market through its subsidiary, MPower, may hinder the realization of full retail competition. MPower enjoys a competitive advantage over other retail electricity suppliers through information possessed by Meralco about its captive customers. These include electricity demand and consumption profiles which allow MPower to make the first offer—and to tailor-fit such offer—to captive customers that qualify to migrate to the contestable market.

Currently, EPIRA does not include provisions that restrict or prohibit cross-ownership in the retail supply sector. Therefore, it is necessary to amend EPIRA to explicitly prohibit such cross-ownership. Alternatively, any new franchise agreement should include provisions requiring Meralco to divest its interest in MPower.

In the interim, the Energy Regulatory Commission (ERC) should extend its regulations, as discussed in Section 3.3, to the retail supply sector to limit cross-ownership.

3.5 Franchise creep

In a recent ruling, the Supreme Court determined that electric cooperatives (ECs) do not have a constitutional right to an exclusive franchise within their service areas.⁸ This opens the door for electricity distribution to become competitive, allowing private DUs to operate in areas previously served by ECs. As discussed in Section 2, the entry of Meralco and other private DUs into new areas brings both potential benefits and risks. While efficiency gains are possible, there are concerns about the abuse of market power as a dominant player like Meralco expands its market share. Therefore, policy must address the potential for anticompetitive effects resulting from such “franchise creep.”

To mitigate these risks, the ERC, the National Electrification Administration (NEA), and/or the Philippine Competition Commission (PCC) should conduct regular audits of private DU operations, including their service areas and pricing practices, to identify any signs of market power abuse. This oversight can help prevent companies from exploiting their expanded market position to charge consumers unnecessarily high prices. Furthermore, if franchise creep results in the loss of more lucrative customers from an EC's service area, the ERC must safeguard against potential rate increases caused by a reduced customer base. For example, in cases such as MORE vs. Iloco in Iloilo, ERC should consider the legal and economic feasibility of implementing surcharges on private DU customers who are transferred from an EC's franchise area to help offset

⁸ <https://www.pna.gov.ph/articles/1230320>

the price increase for the remaining disadvantaged EC customers.

In cases where private DUs and ECs enter into joint agreements, the ERC, PCC, and the SEC should carefully scrutinize the nature of these contracts. It may be advisable to review the ownership structures of the franchise holders to determine whether private DUs have, in effect, control or ownership of the franchise—such as in the case of Clark Electric, which is 65 percent owned by Meralco. This review can help regulators (PCC, ERC, and SEC) assess whether the arrangement could lead to an abuse of dominant market position.⁹

Additionally, the ERC or the NEA in the case of ECs should ensure that the terms and scope of agreements allowing private DUs to operate outside their franchise areas are well-defined and specific. Where possible, these agreements should clearly outline which services and activities the private DUs are permitted to offer, and which they are not, in order to prevent unauthorized expansion of their operations.

Another potential area for reform to improve the efficiency of electricity distribution is the consolidation of franchises held by electric cooperatives and/or private DUs at a higher geographical level, such as the regional level. As shown in Table 4, three regions—National Capital Region (NCR), CALABARZON, and Central Luzon—dominate electricity spending in the country. These regions also account for 56 percent of the country’s Gross Domestic Product (GDP), indicating their economic significance and potential for greater efficiency through regional consolidation.

⁹ In the US FTC, their merger office is broken down into specializations. Currently, the PCC does not have this structure. Given the prominence and frequency of energy cases it might be beneficial to implement a similar specialization structure.

Table 4. Philippine Regions in Terms of Total Electricity Expenditures and Average Electricity Spending per Household in 2018

	Total Electricity Expenditures	Average Electricity Spending per Household
Region I - Ilocos Region	10,900,165,296	8,987
Region II - Cagayan Valley	5,462,899,740	6,408
Region III - Central Luzon	35,647,676,994	12,807
Region IVa - Calabarzon	48,564,255,024	12,917
Region IVb - Mimaropa	4,163,116,050	5,652
Region V - Bicol Region	8,356,680,750	6,526
Region VI - Western Visayas	15,203,221,476	8,299
Region VII - Central Visayas	14,800,578,750	8,047
Region VIII - Eastern Visayas	6,899,154,780	6,518
Region IX - Western Mindanao	4,860,266,790	5,795
Region X - Northern Mindanao	8,061,133,218	7,194
Region XI - Southern Mindanao	9,982,273,128	7,774
Region XII - Central Mindanao	7,417,234,170	6,559
Region XIII - NCR	62,089,685,310	18,711
Region XIV - CAR	2,548,282,740	6,032
Region XV - ARMM	1,249,790,304	1,902
Region XVI - CARAGA	4,107,482,928	6,635

Source of basic data: 2018 Family Income and Expenditure Survey (FIES)

A case can be made for the consolidation of franchises in regions outside of the NCR. Such consolidation can improve operational efficiency by eliminating redundancies and achieving economies of scale, which may lead to lower costs for materials and services. It can also enhance financial stability, as pooled resources increase creditworthiness and access to funding for infrastructure development. Additionally, consolidation can facilitate large-scale infrastructure projects, such as grid upgrades and the integration of renewable energy, while allowing for the standardization of services like billing and customer care. Larger regional franchises would have greater bargaining power with generation companies, potentially leading to reduced electricity costs. Furthermore, regulatory compliance can be streamlined, enabling more effective coordination with government agencies (such as the ERC, DOE, and PCC) and more efficient implementation of national energy policies.

However, several significant challenges must be addressed in the consolidation process. The transition may involve complex logistical, legal, and administrative hurdles that could disrupt

ongoing operations. Additionally, job losses resulting from the shift to more efficient operations could raise concerns, necessitating the implementation of safety nets for displaced workers from affected ECs and DUs. To mitigate these challenges, a well-designed, phased implementation strategy is crucial. This strategy should be underpinned by clear legal and regulatory frameworks, ensuring that the benefits of consolidation outweigh the potential drawbacks.

3.6 Other Reform Issues

In the proposal to involve the ERC in conducting the franchise auction, the ERC would be responsible for determining the eligibility of participants, including Meralco and potential new entrants. This determination would be based on an assessment of the financial, technical, and legal performance of the bidders, in accordance with the minimum standards established by the ERC.

In this context, we propose that the government's optimal policy would be to conduct a repeat auction rather than automatically renewing Meralco's franchise for another 25 years upon its expiration. The need for increased competition in the retail electricity market is becoming increasingly apparent and should no longer be overlooked. The passage and implementation of the EPIRA suggest there is room to enhance competition, both in power generation and in distribution.

To improve regulation following the grant of the franchise, periodic regulatory reviews can continue to set caps on retail prices. However, such measures must be informed by accurate demand-side information. The ERC should recognize that end users are not entirely price-insensitive, and static retail prices are inefficient.

As regulatory reforms progress on both the demand and supply sides, the prospects for fostering genuine retail competition grow. This area remains a lagging aspect of EPIRA's implementation. The DOE can encourage the relevant agencies to expedite their programs and projects as outlined in their terms of reference.

4. Concluding remarks

The forthcoming renewal of Meralco’s franchise offers a critical policy window to implement structural reforms in the electricity distribution sector. Rather than treating future franchise renewals as a procedural matter, it should be viewed as an opportunity to address longstanding inefficiencies, mitigate market concentration, and realign sectoral governance with the objectives of the Electric Power Industry Reform Act (EPIRA) of 2001. More than two decades after EPIRA’s enactment, its vision of a competitive, reliable, and consumer-oriented electricity market remains only partially realized.

This paper has identified key structural concerns, including the vertical integration of Meralco with affiliated generation companies, its dominant presence in the retail electricity supply market, and the expansion of its control across multiple franchise areas—collectively contributing to reduced market contestability and potential regulatory capture. These issues are compounded by the limitations of the current legislative franchise system, which lacks the institutional agility and technical capacity required for dynamic market oversight.

To address these challenges, we propose a transition from automatic legislative franchise renewal to a competitive franchise auction framework. Such a mechanism would replace entrenched monopolistic structures with a system of “competition for the market,” enabling qualified distribution utilities to bid for service areas under transparent, performance-based criteria. Institutionalizing this reform would not only drive efficiency and cost-effectiveness but also enhance public accountability and consumer welfare.

We further recommend vesting franchise-related functions in the Energy Regulatory Commission (ERC), which possesses the requisite technical and regulatory capabilities. The ERC’s role should be complemented by enhanced mandates for the Philippine Competition Commission (PCC) to monitor market behavior and enforce anti-monopoly safeguards, particularly in relation to cross-ownership and affiliate sourcing practices. Policy options such as franchise unbundling, caps on affiliate contracting, and stricter definitions of control and ownership should be explored to mitigate conflicts of interest and ensure market integrity.

Moreover, the geographic partitioning of Meralco's service area into smaller, auctioned franchise zones merits serious consideration. Such a strategy could foster intra-sectoral benchmarking, reduce systemic risk, and promote operational specialization. Regional consolidation of distribution utilities—particularly in high-growth economic zones—may also yield efficiency gains through scale economies and more effective grid integration. However, these measures must be balanced against the need to protect consumers in underserved or marginal areas, ensuring that reforms do not exacerbate existing service inequalities.

While the automatic extension of Meralco's franchise represented a missed opportunity to modernize the governance of electricity distribution in the Philippines, there should be a deliberate shift toward competitive, transparent, and institutionally robust frameworks to realize the full potential of EPIRA. Implementing these reforms would not only improve sectoral efficiency and equity but also contribute to broader goals of sustainable development and inclusive economic growth. This will ensure far-reaching improvements for energy policy, market competition, and public welfare in the decades ahead.