

**REGULATORY CAPTURE, RECAPTURE AND RUPTURE:
THE CASE OF THE CALIRAYA-BOTOCAN-KALAYAAN
HYDROPOWER PLANT COMPLEX AND IMPSA**

by

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Introduction

- IMPSA case is the longest running telenovela or soap opera in the Philippines
- Already 11 years in the making it is also comparable to an epic movie
 - All star cast

• On the Philippine side:

- 3 Presidents
- 3 sets of cabinet officials including 2 executive secretaries
- 3 sets of corporate officials
- 2 congressmen
- 4 senators
- 5 ambassadors
- hundreds of minor officials





Abrille



J. Osmeña



Lacson



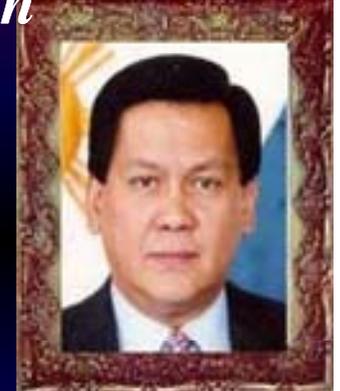
Villarama



Jimenez



Perez



S. Osmeña



Pardo



Espiritu



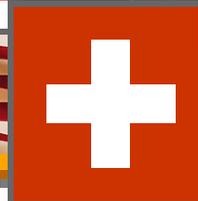
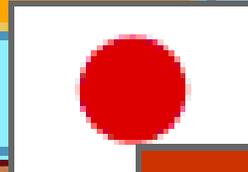
Pimentel

On the International side:

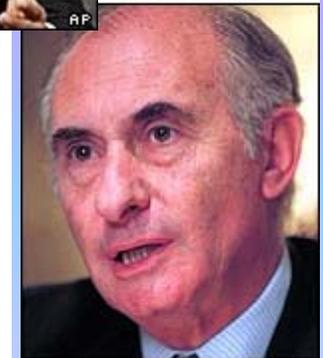
- 2 Argentinian Presidents
- 1 Argentine firm
- 4 governments: Argentina, Switzerland; United States and Japan
- 1 American company



Valenti



Menem



De la Rúa

Introduction...

- **Probably the most documented case**
 - **Verbatim records of proceedings of 11 Senate Hearings**
 - **Documents from the Department of Finance and the Department of Justice**
 - **Interviews of key players in the case**
 - **Series of articles by the Philippine Center for Investigative Journalism**
 - **Daily coverage in multi-media at the height of the hearings**



CONCEPTS OF STATE CAPTURE AND REGULATORY CAPTURE



STATE CAPTURE

- The term “state capture” is often used to describe capture in transitional economies
- The efforts of firms to shape laws, policies and regulations of the state to their own advantage by providing illicit private gains to public officials (Hellman and Kaufmann)
- Corruption is seen as an indication that state institutions are weak and are susceptible to capture...where policy making is biased towards particular firm (Hellmann, et.al.)
- The representatives who are supposed to represent the general interest are “actually selling their decisions for money” (Ocampo)
- Describes a situation where not only specific regulatory agencies are captured, but also the entire government system

REGULATORY CAPTURE

- **Regulation as response to the pressures from interest groups (Reagan)**
- **Meant behaviors, active and passive, by responsible authorities, which behavior act to protect the same illegal, unethical, immoral or anti-public interest practices that those authorities are charged of policing (McMahon)**
- **Three distinct forms of capture (Baldwin):**
 - **identification with the industry**
 - **sympathy with particular problems that regulated firms confront in meeting standards**
 - **absence of toughness**

REGULATORY CAPTURE

- regulatory agencies go through four stages in what Bernstein calls the regulatory life cycle
- Stigler focused on the struggle of interest groups in maximizing economic rents from regulatory decisions
- Groups organize to exert pressure on the political process (Becker)
- Policies of the agency are designed primarily to benefit the needs of existing firms (Peterson)
- Regulatory agencies become the firms' advocate (Rees and Vickers)
- Instead of regulation by government, it has ended up with regulation of government by business (Reagan)

REASONS FOR CAPTURE

- **Asymmetries of information**
- **Revolving door theory**
- **Situational pressure**
- **Weak points of the regulators are the strong points of the regulated industry**
- **Corruption and bribery are often identified with regulatory capture**

CHARACTERISTICS OF A CAPTURED AGENCY

(Basilio and Villaseñor)

- **It furthers the industry's interests at the expense of consumers**
- **It is more responsive to the industry pressures**
- **It has become too identified with the industry**
- **It has become overly protective toward the regulated firms**
- **It is passive, largely rubber stamping the firm's decision**
- **It adopts the regulated utilities objectives as its own**

SOME DOCUMENTED CASES OF REGULATORY CAPTURE IN THE PHILIPPINES



Benefiting from its Own Regulation: The Case of the Philippine Ports Authority

- According to Basilio, “there are as many examples in the PPA that demonstrate the phenomenon of regulatory capture”



CIVIL AERONAUTICS BOARD: PAMPERING THE “FLAG CARRIER”? *(based on Villaseñor’s paper)*

- **The Philippines-Taiwan air accord was abrogated in order to protect the ailing Philippine Airlines**
- **The grounds according to the CAB are the following:**
 - **violations on seat capacity**
 - **dumping of prices**
 - **violations on sixth freedom**
- **The protection extended to PAL had received criticisms from other stakeholders of the air transportation industry**
- **PAL does not represent the whole industry**



PEA-AMARI DEAL: GRANDMOTHER OF ALL SCAMS

(Philippine Center for Investigative Journalism)

- **The deal revolved around the three islands along the coastal road and a staggering amount of Php1.75 billion in bribes and commissions**
- **The three islands were sold to the Amari Coastal Bay Development Corporation**
- **The deal was hounded by controversies**
- **A series of pay-offs in the forms of bribes and commissions was given to the brokers of the project, government officials and even to the competitor corporation (according to PCIJ)**
- **The anomalous deal passed through the scrutiny of government agencies primarily established to prevent such anomalous contracts**



THE PIATCO FIASCO?

(based on the Senate Committee Report no. 130)

- **The terminal 3 project started as an unsolicited proposal**
- **The 1997 CA between DOTC/MIAA and PIATCO was not cleared by the ICC**
- **The agreement substantially deviated from the Bid Documents and it violated the BOT law's prohibition against direct government guarantee**

- **The amendments in the contract are “grossly disadvantageous and onerous to the government**
- **Illustrates how the BOT law was “subverted and flouted with impunity when the government agency involved is guilty of malicious breach or inexcusable negligence or ignorance in the performance of duty” (Senate Committee Report)**



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THE IMPSA-CBK CONTRACT

- **A 25-year build-rehabilitate-operate-transfer (BROT) contract**
- **Involves the plants in Kalayaan, Botocan and Caliraya which are all in Laguna**
- **The plants full capacity when the project is completed is 728MW which would double its current 400MW capacity**
- **The BROT Project consists of the Kalayaan Stages 1 and 2; Calariya Hydropower Plant; and the Botocan Hydropower Plant**
- **The plants will function as a grid stabilizer balancing the supply and demand of electricity**



THE IMPSA-CBK CONTRACT

- The Argentina-based Industrias Metalurgicas Pescarmona Sociedad Anonima (IMPSA)

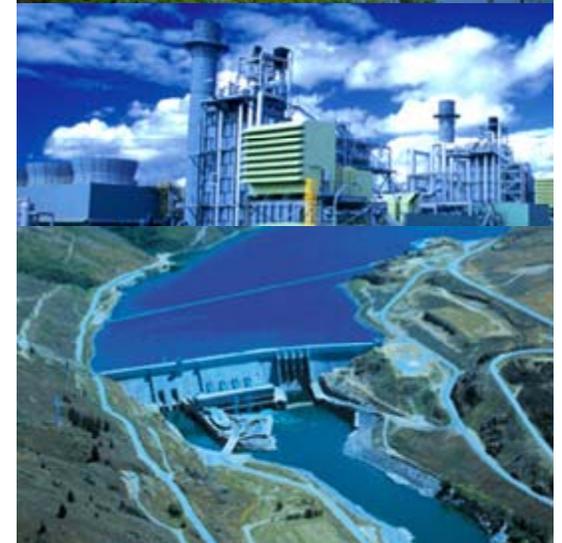
- IMPSA considers itself as one of the foremost constructors of hydropower plant around the world

- IMPSA has presence in more than 20 countries including the Philippines, China, Malaysia and US among others

- When IMPSA was unable to raise enough funding, it forged partnership with an American firm Edison Mission Energy (EME)

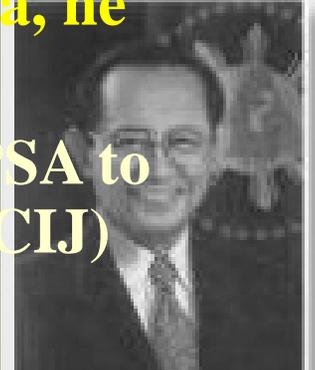
THE IMPSA-CBK CONTRACT

- **EME has over 75 projects in countries in America, Europe, Middle East and Asia Pacific**
- **IMPSA and EME are 50-50 partners in the CBK Power Company Ltd.**
- **CBK Power Company Ltd. will build, rehabilitate, and operate the three hydroelectric plants**



The Ramos Regime: Regulatory Capture?

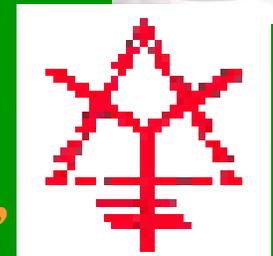
- In the 1993 state visit of President Ramos to Argentina, he promised the CBK deal to IMPSA (PCIJ)
- President Ramos invited the Argentine company IMPSA to rehabilitate the CBK hydro power plant in Laguna (PCIJ)
- CBK contract deal as a *quid pro quo* for the port privatization project in Argentina which was won by a Philippine firm, ICTSI (PCIJ)
- Ambassador to Argentina Villa Abrille facilitated IMPSA proposal (PCIJ)
- In 1994, NPC refused the joint venture with IMPSA
- When Argentine President Menem visited the Philippines in October 1995, the IMPSA proposal was also taken up.
- Based on technical qualifications, IMPSA and First Power Corporation, Inc.(FPPC) were both initially disqualified but were re-evaluated based on financial proposals.



PRESIDENT RAMOS REGIME...

- NPC and IMPSA sign a MOU to develop CBK Project and reach a BROT agreement with NPC
- On 5 October 1995, NEDA-ICC approved both the project and the IMPSA under the category of unsolicited proposal
- Unsolicited proposals don't carry government guarantee**
- On October 6, 1995, a second MOU was signed witnessed by President Ramos and President Menem

“NPC and IMPSA agreed to exert their best effort to obtain the necessary clearance of NEDA as to immediately proceed with the steps provided for the Unsolicited Proposal process, including the call for comparative proposals and shall immediately follow each of the remaining steps toward the conclusion of the Contract.”



PRESIDENT RAMOS REGIME...

- **FPPC consortium submits a comparative proposal**
- **FPPC files charges against NAPOCOR and IMPSA on the bidding procedure conducted and was able to secure a TRO from the Pasig RTC on 13 January 1998**
- **The TRO expired and NPC started negotiation for the implementation of the project**
- **On May 1999, the Court of Appeals issued a final order of dismissal with respect to the withdrawal of the appeal filed by the FPPC**
- **On 22 June 1998, the NPC Board approved and confirmed the BROT Agreement**
- **When Ramos' term was finished, the IMPSA deal was one of the projects he personally endorsed to the new administration**

Estrada Regime: 'Drinking the Kool-Aid'

- The BROT contract between IMPSA and the NPC was signed in Malacañang with then President Estrada signing as a witness on 6 November 1998

- Manila Times published a report on 16 February 1999 calling President Estrada an “unwitting godfather” to an anomalous contract

- IMPSA-Asia President Valenti wrote the DOF asking for a performance undertaking

- In July 1999, Businessman Mark Jimenez began following-up the signing of all the documents required for the CBK project and made the \$14 million offer for the “projects of the Office of the President” (statement of President Estrada)



PRESIDENT ESTRADA REGIME

- **Finance Secretary Edgardo Espiritu reluctantly signed a performance undertaking on 12 July 1999**

...we hereby confirm that the obligations of NPC under the Agreement carry the full faith and credit of the Republic of the Philippines and that the Republic of the Philippines will see to it that NPC shall be able to discharge at all times such obligations as they fall due.”

- **On 29 September 1999, President Estrada discussed CBK Project with President Menem in Buenos Aires**
- **IMPSA commenced the works at the site on 7 February 2000**

PRESIDENT ESTRADA REGIME

- **On March 16, 2000, the DOF received a request from the Ministry of International Trade and Industry (MITI) of Japan seeking clarification of the Government Undertaking signed by Espiritu (statement of Pardo)**
- **Sen. Serge Osmeña delivers privilege speech questioning CBK on 20 March 2000**
- **A second privilege speech was delivered by Sen. Serge Osmeña on 28 March 2000 attacking CBK and IMPSA**
- **Argentina President De la Rúa wrote to President Estrada asking for assistance to resolve pending issues on the project**

PRESIDENT ESTRADA REGIME

•On 28 June 2000, Secretary Tuquero issued a legal opinion in connection with the Government Undertaking

...the obligations expressed to be assumed by the Republic of the Philippines in the Government Undertaking are, under the laws of the Republic of the Philippines, legal, valid and binding obligations of the Republic of the Philippines, and enforceable against it in accordance with the terms thereof, including in the event of National Power Corporation's privatization, dissolution, bankruptcy, insolvency, or merger.

PRESIDENT ESTRADA REGIME

- **American firm, Edison Mission Energy, entered into the picture diluting IMPSA's equity to 50%**
- **The entry of EME required numerous contract amendments**
- **The new Finance Secretary Jose T. Pardo was reluctant to sign anything which might be taken as a government guarantee**
- **Secretary Pardo states that U.S. Ambassador Tom Hubbard followed up the government undertaking (interview with Pardo)**

PRESIDENT ESTRADA REGIME

- On December 28, 2000, Pardo gave in by signing a GACA

“For the avoidance of doubt, it is understood that nothing in this letter agreement shall be construed so as to convert the Government Undertaking to a direct guarantee by the Government of the obligations of CBK to the lenders under the Omnibus Agreement. Neither shall it be construed to increase or expand the obligations of the Republic of the Philippines under the Government Undertaking dated July 12, 1999.”

PRESIDENT ESTRADA REGIME

- **Villa Abrille, together with IMPSA officials, visited President Estrada at his Polk Street residence (PCIJ Report as confirmed by President Estrada's statement)**
- **On 17 January 2001, Pardo sought the opinion of the DOJ on the validity and legality of the GACA**
- **Given the EDSA revolt, Pardo withdrew his request for the DOJ ruling**
- **Former Finance Secretary Espiritu came out in public identifying the IMPSA as an anomalous contract (PCIJ)**
- **Estrada was ousted on 21 January 2001**

Arroyo Regime: Regulatory Recapture?

- Villa Abrielle was seen to have visited Linden Suites, which was the headquarters of President Arroyo during the EDSA II (PCIJ)
- The newly appointed Justice Secretary Hernando Perez released the DOJ opinion dated 24 January 2001 on 1 February 2001

“the Republic of the Philippines has validly and effectively consented to the transfer and assignment to the Lenders of all of CBK’s rights under the Government Undertaking.”

- 19 banks agreed to put their money into the CBK Project
- On 7 February 2001, the NPC formally handed to IMPSA the management and operation of the CBK power complex

PRESIDENT ARROYO REGIME

- **Unit 1 of Kalayaan is completed on 21 March 2002**
- **Sen. Serge Osmeña pressure DOE to block the payments to CBK**
- **Meritec Ltd. reported to DOE**

“the capital recovery fee provided in respect of Units 1 and 2 seems excessive in comparison to the amount of capital that the contractor (IMPISA) has invested in these units.

- **On 22 October 2002, Sen. Serge Osmeña gave a privilege speech at the Senate attacking CBK**
- **Senators Serge and John Osmeña continued the senate hearings**

Regulatory Rupture

- **Representative Willie Villarama privilege speech on the Cabinet's "multi-million dollar man" (12 November 2002)**
- **Representative Mark Jimenez, in a privilege speech confirmed that Secretary Perez extorted \$2 million dollar from him (25 November 2002)**
- **Secretary Perez denies the allegations**
- **Senator Lacson, during the Senate Hearing disclosed how the alleged \$14 million bribe was distributed**
- **The Swiss government requested the Philippine Government for legal aid on a criminal matter**

"...the Department of Public Prosecutor of the Swiss Confederation is leading a police judiciary investigation... against: PEREZ Rosario Salvador...PEREZ Benito Hernando...ARCEO Ramon Antonio Castillo..., and ESCALER Ernest De Leon...for money laundering..."

Issues

- The January 24, 2001 DOJ legal opinion provides for a direct government guarantee which the DOJ denies
- The Perez opinion has triggered opposing interpretations of the legal opinion: Tuquero vs. DOJ
- It led to the effectivity of the BROT contract
- Accusations of extortion by a high government official has surfaced
- The accusation was denied

Direct Government Guarantee or Not?

He Says... She Says...

•On the Perez Opinion

Tuquero: *Perez's opinion provided for a direct government guarantee by recognizing the validity of all CBK rights under the government undertaking*

Gutierrez: *The legal opinion did not provide for a direct government guarantee because the Secretary of Justice had no authority to provide it*

He Says... She Says...

•On the Perez insertion

Tuquero: *the inclusion of that additional portion provided direct link for the lenders, IMPSA and the collateral agents to the NPC and the National Government*

Gutierrez: *the insertion is merely a reinstatement of the representation in the GACA*

On the Effective Date of the BROT Agreement

Tuquero: *the opinion of Perez led to the effectivity of the IMPSA deal*

Gutierrez: *the effective date of the BROT agreement is provided in the agreement itself*

Regulatory Capture or Regulatory Rupture?

- Whether there was a direct government guarantee or not, what is clear is that the latest DOJ opinion satisfied the lending banks who finally agreed to fund the project

In the meantime...

- The Senate Hearings are going on...
- The debate in media about Nani's case continues
- The Swiss government is still waiting for the action of the Philippine government

Regulatory Capture or Regulatory Rupture?

- Does the IMPSA case contain the characteristics of regulatory capture?
- Is it routine for Presidents and ambassadors to follow up projects in behalf of private parties?
- What constitutes a direct government guarantee- Estrada or Arroyo?
- What are the implications of Swiss Government request for legal aid on criminal case?
- What policy actions must be undertaken to prevent regulatory capture?

THANK YOU

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