

Food for Thought

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PRESS RELEASE: IS THE GOVERNMENT PASSING ACTUAL AND EFFICIENT COST TO ELECTRICITY TARIFF?

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PRESS RELEASE

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IS THE GOVERNMENT PASSING ACTUAL AND EFFICIENT COST TO ELECTRICITY TARIFF?

Based on World Bank's data, Malaysia's average annual increase in Gross Domestic Product (GDP) between year 2004 and 2011 is 4.88%. According to National Energy Balance 2011, average annual increase in Primary Energy Demand is 4.1% and average annual increase for electricity demand is 4.88% between year 2004 and 2011. This is evidently showing that Malaysia's GDP growth is heavily dependent on energy and it is not a very sustainable and healthy growth.

Malaysian government has been neglecting energy efficiency for decades. In the 10th Malaysia Plan, government pledged to increase its commitment to energy efficiency and stronger governance in electricity industry to increase its productivity as well as efficiency. 3 years has passed and we can observe the opposite being implemented.

Association of Water and Energy Research Malaysia (AWER) has noticed many contradicting statements about subsidy and electricity industry by government agencies. The following issues are raised by AWER based on our research studies, consultation with MyPower Corporation and Energy Commission (ST) as well as actual implementation that should be carried out to address our growing energy demand.

Point 1: Where do the savings from subsidy removal go to?

According to media statements by President and CEO of Petronas, Tan Sri Shamsul Azhar Abbas, the 'discounted' natural gas price is Petronas's foregone revenue. Therefore, increasing natural gas price or usually referred to as subsidy removal will definitely increase revenue to Petronas. Petronas has also made its commitments made known via media that it will increase its Capital Expenditure (Capex) spending to develop its businesses and subsequently, Operational Expenditure (Opex) will increase. It is commonly known that a company will pay tax and dividend based on its profit. Now, how much does the government receive as income from Petronas after deducting these Capex and Opex? This additional 'income' from Petronas was promised to be used for social and infrastructure benefits during the June 2011 tariff increase when government raised the natural gas price by RM 3 per mmBTU (million metric British Thermal Units). How many schools or roads or bridges have been built additionally from this income? What is the actual accounting of the spending?

When natural gas price is increased, it increases revenue to Petronas directly. Now, who do you think will benefit from this upcoming tariff increase? Tenaga Nasional Berhad (TNB), Petronas, Public or Government? Therefore, in the upcoming natural gas price adjustment, the government must publish projected income from subsidy removal to the government and how government plan to use this income in details. 24 hours is more than enough for government to publish such data as government should have all the details with them by now.

Point 2: What is the cost structure in electricity industry?

There are 3 main cost in electricity tariff, namely, generation cost, transmission cost and distribution cost. Based on our consultation with ST, the cost breakdown is as following: Generation cost (74%), Transmission cost (7%) and Distribution cost (19%). The generation cost is further broken down to fuel cost (68%) and capacity charges cost (32%). The capacity charges cost is for both Independent Power Producer (IPPs) and TNB plants. It is also estimated that more than 70% of the capacity charges goes to IPPs due to lopsided Power Purchase Agreements (PPAs). By renegotiating or 'correcting' IPPs' capacity charges, there is a good probability of reducing overall cost impact to tariff by more than 8%.

Based on the cost structure of electricity tariff, increase in fuel cost will give the biggest impact to tariff. Unfortunately, generation cost is neither regulated nor made to be efficient by ST and the government. ST is only regulating the transmission and distribution cost which amounts to 26% of the total cost of electricity tariff through Incentive Based Regulation (IBR). This is contradicting with government's pledge in the 10th Malaysia plan.

For example, the new Prai plant that was approved via competitive bidding process has 60% generation efficiency. This means, if 100 unit of natural gas was supplied, 60% of the natural gas will be converted to be useful form of energy. ***Due to delay in renegotiating first generation Power Purchase Agreements (PPAs), government staged so called 'successful open bidding' process for the expiring IPPs and claimed it as a 'renegotiation' step to 'reduce' IPPs' capacity charges 'substantially'***. These plants should have retired from operation by year 2017, but now, it will be extended for another 10 years from their respective retirement dates. Average efficiency of these plants is 40%. If 100 unit of natural gas was supplied to this plants, only 40% of the natural gas will be converted to be useful form of energy. But, consumers and businesses will still pay for the same 100 unit of natural gas. Is this the efficiency government is talking about via Fuel Cost Pass Through

(FCPT)? This type of decision is not creating an equitable tariff as the inefficiency in fuel cost is passed to tariff.

Averagely, construction of new (and efficient) power plant takes between 3 to 5 years. ST and the government had all the time to build more efficient power plants, but they resorted to extending few first generation IPPs due to 'insufficient' time to plant up. The reason for 'insufficient time' is totally unacceptable as the renegotiation with first generation IPPs was started in year 2007. Now, is it fair for the consumers and businesses to bear IPPs' inefficiency cost?

Point 3: What is the true cost of Fuel?

Based on information received from MyPower Corporation, 1MDB is planning to be the next entity that is going to bring in coal presumably by buying coal mines overseas. This in return 1MDB will be able to give coal at cheaper price for Malaysia. This was the justification of increasing electricity generation capacity using coal. Will this ensure we be able to get cheaper coal? Unfortunately, example shown by Petronas for natural gas price is vice versa. Eventually, market price will be imposed.

Based on discussions, the gas price quoted at RM 42 - RM44 per mmbTU is the cost for Liquefied Natural Gas (LNG) that comprises cost of converting natural gas to liquid form, transportation cost from port to port, regasification cost and distribution cost. Petronas President and CEO has announced that Petronas welcome any entity to bring in LNG at cheaper rate. Unfortunately, both industrial and electricity sector has been complaining that there is no cost breakdown shown for regasification cost and cost of using Petronas's pipeline. Without these costs, no one dares to bring in their own LNG. Moreover, there is natural gas flowing directly from off shore locations to Petronas's gas pipeline in peninsular. ST has also raised similar issues with AWER and said their hands are tied. Now, is government passing true fuel cost to both consumers and businesses?

Point 4: Why ST did not carry out transparent tariff setting mechanism?

During AWER's discussion with ST, ST was more than willing to carry out transparent tariff setting as per our suggestion. But, ST was also quick to point out that their hands are tied on this issue. AWER's suggestion on transparent tariff setting comprises that the government must announce proposed tariff adjustments to public via detailed summarised cost structure and the detailed proposed increase. Subsequently, they must also carry out public consultations and gather feedback on the proposal and make a final announcement on the tariff structure. Calling only few NGOs for briefing session is not public consultation. AWER has successfully pushed for such a tariff mechanism for water services sector under Suruhanjaya Perkhidmatan Air Negara (SPAN). Now, will Minister of Energy, Green Technology and Water (KeTTHA) allow transparent tariff setting for electricity and gas sectors in the upcoming tariff increase?

Point 5: What is the estimated tariff increase?

Based on information gathered from meetings with MyPower and ST, Petronas will be imposing two tiers pricing for natural gas. Electricity sector uses around 1300 mmscfd (million standard cubic feet per day) natural gas for electricity generation and the first 1000 mmscfd will be at

regulated (or well known as subsidy) price. The balance 300 mmscfd and above will be sold to electricity sector at RM 42 - RM44 per mmBTU (market price). AWER is estimating the tariff increase components as following:

Current gas price: **RM13.70**

Current average tariff: **33.54 cents/kWh**

Proposed tariff increase (%): **10% to 20% (based on KeTTHA minister's statement)**

Proposed tariff increase (cents): **3.35 cents to 6.70 cents**

Three cost components that will be included: **Coal price, gas price and TNB's base tariff**

| Estimated gas price increase | Harga gas asli (RM) | | | Impact of gas price increase 300 to tariff (cents / kWh) | New average tariff with gas price only (cents / kWh) [at average tariff 33.54 cents/kWh] |
|---|---------------------|------|----------------|--|--|
| | First mmscfd | 1000 | Balance mmscfd | | |
| First tier increase by RM 1.50 per mm BTU | 15.20 | | 42.00 | 4.10 | 37.64 |
| First tier increase by RM 3.00 per mm BTU | 16.70 | | 42.00 | 4.71 | 38.25 |
| Flat RM 3.00 per mm BTU increase without tier | 16.70 | | 16.70 | 1.60 | 35.14 |
| Flat RM 6.00 per mm BTU increase without tier | 19.70 | | 19.70 | 3.20 | 36.74 |

(Estimations and calculations are based on information by MyPower, ST, June 2011 Tariff increase press statements from KeTTHA and Economic Planning Unit)

If government is allowing first 1000 mmscfd to have RM 1.50 per mmBTU increase, tariff increase will be between 15% and 17% to 38.57 cents/kWh and 39.24 cents/kWh respectively. If government is allowing first 1000 mmscfd to have RM 3.00 per mm BTU increase, tariff increase will be between 17% and 19% to 39.24 cents/kWh and 39.91 cents/kWh respectively. If we refer to government's previous plan to increase gas price at flat RM 3.00 per mmBTU for all 1300 mmscfd of natural gas used, average tariff increase can be capped between 7% and 9% to 35.89 cents/kWh and 36.56 cents/kWh respectively. In addition to that, if a flat RM 6.00 per mmBTU increase is imposed for all 1300 mmscfd of natural gas used, tariff increase still can be capped between 12% and 14% to 37.56 cents/kWh and 38.24 cents/kWh respectively. All the estimations include also TNB's base tariff increase and coal price pass through. Based on the data above, it is evident that the increase in natural gas price will give high impact to electricity tariff increase especially using two tier pricing mechanism.

This is also the main reason why AWER is requesting government to be transparent in the tariff setting for the past 3 years. Now, it is time for government to publish the breakdown of each cost component in the tariff including the fuel cost breakdown so that the people understand what they are paying and the businesses can forecast their future expenditure due to tariff increase. This will assist potential investors to evaluate

their investment strategies in Malaysia too. All in all, it is a win-win situation for all parties.

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