Suruhanjaya Tenaga

Headline	Tenaga has to justify hike		
MediaTitle	The Edge		
Date	09 Dec 2013	Color	Full Color
Section	Corporate	Circulation	23,565
Page No	1,14	Readership	120,000
Language	English	ArticleSize	806 cm²
Journalist	Ben Shane Lim	AdValue	RM 13,878
Frequency	Weekly	PR Value	RM 41,634

Tenaga has to justify tariff hike

BY **BEN SHANE LIM**

The upcoming hike in electricity rates should not come as a big surprise as the government had begun to warn of more fiscal consolidation soon after the 13th general election in May ended.

Nonetheless, the tariff hike, which takes effect next year, will put Tenaga Nasional Bhd under increased public scrutiny, given that the increase of 4.99 sen/kWh or 14.9% covers more than just fuel costs — something the public is not comfortable with.

After all, higher electricity bills should pay for rising energy costs, not inefficiencies. So, the million-dollar question is, is Tenaga being run efficiently and does it deserve the tariff hike?

Even Youth and Sports Minister and Umno Youth chief Khairy Jamaluddin has come out to criticise the tariff hike, pointing out that it is not in line with the increase in fuel prices.

Of the increase of 4.99 sen/kWh — which raises the average tariff to 38.53 sen/kWh — 82% or 4.09 sen/kWh will be used to offset rising fuel costs. The remaining 0.9 sen/kWh or 18% is going to Tenaga's base tariff. Based on the nation's current electricity consumption of around 105GWh per annum, this translates into an addition of almost RM1 billion to Tenaga's revenue.

The energy provider posted an adjusted net profit of RM4.6 billion in FY2013 ended Aug 31, up 46.4% from the previous year, mainly due to lower fuel costs. Now add RM1 billion to the current financial year's earnings.

To be fair, Tenaga must ensure grid security, which involves huge non-discretionary capital expenditure — to the tune of RM6 billion a year compared with its net profit of roughly RM4 billion. Meanwhile, it has no control over its electricity tariff.

The Energy Commission (EC) points out that the 0.9 sen/kWh increase will be regulated through incentive-based regulation (IBR) that will incentivise Tenaga to be more efficient. Simply put, this means Tenaga will be rewarded with a higher tariff if it meets certain key performance indicators (KPIs) set by the regulator.

The regulator acknowledges the fact that the electricity utility is not operating at optimum efficiency and that there is room for improvement.

"Our role is to incentivise Tenaga to be efficient," says MyPower Corp CEO Datuk Abdul Razak Majid in an open discussion with the media last week. Abdul Razak had served in Tenaga for 36 years before being appointed EC deputy chairman in October.

Tenaga did not respond to questions from *The Edge*, but the EC is making no secret of the fact that the energy provider can be better run.

Tenaga's staff cost, for example, needs a hard look. It has spiked 28.3% since Datuk Azman Mohd took over from Datuk Seri Che Khalib Mohd Nor as the president and CEO in the middle of last year. Even after stripping out retirement benefits and share options, the company's wages, salaries and bonuses were up 27.5% to RM2.1 billion in FY2013. However, revenue only rose 4%. If total staff cost had grown by a similar percentage, Tenaga's net profit would have been about RM650 million or 14% higher.

The accounts do not clearly indicate if the increase in staff cost was due to a higher headcount or increments and bonuses. It is also unclear which segment is incurring a high cost.

Tenaga has to be transparent

As a public-listed, government-linked entity and a monopoly that deals with regulated assets, there is no reason why there cannot be high transparency of Tenaga's accounts.

Abdul Razak agrees that the energy provider's actual efficiency and performance are difficult to pinpoint because its accounts are lumped together.

"Tenaga's accounts have already been separated, but we have not come to a stage where we can make them public. The company has asked for a slight moratorium because the separation of its accounts is not 100% done yet," he says.

"There is still a little bit of grey area that we need to streamline to go along with IBR. As a regulator, I would love to make Tenaga's accounts transparent."

Currently, all three of Tenaga's businesses — generation, transmission and distribution — are bundled together (see diagram).

However, capex from the 0.9 sen/kWh hike is allocated specifically to transmission and distribution. As the sole off-taker of power in Peninsular Malaysia, Tenaga is a monopoly on transmission and distribution. This brings the competitiveness of these divisions into question. Without accounts separation, there is no way to know the efficiency of the transmission and distribution divisions.

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At the generation level at least, there is some semblance of competition to ensure efficiency. A recently established single-buyer subsidiary procures power from various generators — either Tenaga's own plants or independent power producers — by merit order. This means the most efficient plants that offer the cheapest power are given priority. Therefore, plants must be efficient or they will be under-utilised.

"Of the three businesses, generation is the riskiest and should command the highest WACC (weighted average cost of capital). So at the very least, the WACC of transmission and distribution should be lower than that of generation," an industry player points out.

"With accounts separation, we can also benchmark Tenaga's efficiency against that of energy providers in other countries."

This raises another question: If Tenaga's accounts separation and IBR benchmarks are not revealed, how will the public know the basis for the 0.9 sen/kWh hike in rates?

"I can't give you the numbers, but IBR has already been implemented. The 0.9 sen/kWh is only the trial stage and will help us fine-tune the system. It will only be fully implemented in 2015," explains Abdul Razak.

The fuel cost pass-through, which makes up 4.09 sen/kWh or 82% of the tariff hike, is an inevitable move to align electricity tariffs with rising global energy prices, particularly when the government needs to contain the country's ballooning budget deficit.

The hike will enable Petroliam Nasional Bhd (Petronas) to reduce its revenue foregone of RM4 billion due to the sale of natural gas at substantially low regulated prices to the domestic market.

Nonetheless, industry players point out that the fuel cost pass-through should be due to an increase in fuel prices and not the burning of more expensive fuels because of a mismanagement of assets that causes technical problems, such as unplanned power plant outages.

Tenaga has been forced to burn more gas than necessary due to unscheduled outages in the cheaper coal-fired plants across the grid. This costs more because gas-fired plants are not meant for the production of base-load supply. Coal-fired plants are more suitable for this.

Worse still, there was a shortage of natural gas before the regasification terminal in Melaka started operating in May. Consequently, Tenaga had to burn oil and distillates, which are expensive. Not surprisingly, its oil and distillates bill for FY2013 was RM4.5 billion.

The additional fuel cost was borne equally by the company, the government and Petronas.

However, should a gas shortage recur, will the EC's decision on a tariff review be affected?

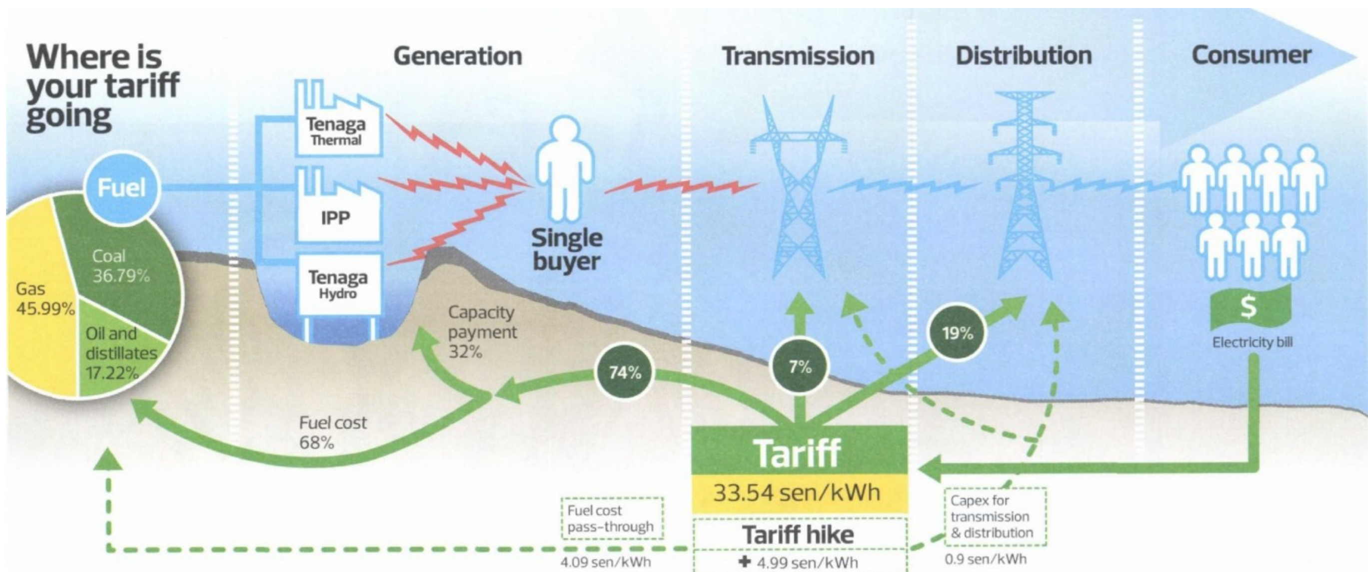
Tenaga holds an estimated RM500 million in withheld capacity payments to independent power producers that have fallen below their contractually obligated availability targets due to outages and in penalties it has imposed on them.

The exact amount is not mentioned in Tenaga's accounts and the EC will not reveal it. Based on IBR, Abdul Razak says the money must be kept in a separate account and should go back to the consumer.

If the money is part of IBR, why can't it be used to offset some of the current tariff hike?

However, all Abdul Razak will say is that it will come into play in the next tariff review.

Cost pass-through is inevitable when there is a spike in fuel prices. But tariff hikes should not be revenue enhancers for Tenaga. To avoid this, the utility has to be efficient while the regulator needs to be transparent and fair to all. E



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