



Eskom RCA applications 2019

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Eskom Tariff and RCA applications

AFRIFORUM

- AfriForum NPC (a non-profit company) registered in South Africa with, among other aims, constructive participation in matters of Government, such as the making of submissions regarding applications for revenue by Eskom on behalf of its members and in the public's interest.
- AfriForum has been active in the energy industry for several years by making submissions regarding applications for electricity price increases on Local Government level, as well as participating in various public hearings in this regard held by NERSA.
- Has more than 215 000 members and 110 branches across South Africa that actively take part in service delivery issues, including electricity supply.

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BACKGROUND

- Eskom as company has an obligation not only to generate power but to do it in such a way that it is effective, affordable and prudent. ESKOM has a further obligation to only incur lawful operational and capital expenditure in execution of its licensed activities;
- Eskom is a profit generating company.
- NERSA is a juristic person that has the authority to regulate the monopoly on electricity.
- NERSA has the authority to consider Eskom's applications with input from stakeholders, communities, organisations, etc.

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MYPD CRITERIA

- The MYPD establishes the following criteria for the operating expenses to be allowed:
- Expenses must be incurred in the normal operations of production and supply of electricity, including an **acceptable level** of refurbishment, repairs and maintenance costs;
- Expenses must be **prudently** and **efficiently** incurred after careful consideration of available options;
- Expenses must be **incurred in an arm's length transaction**. ESKOM must have a **competitive procurement policy and demonstrate to the regulator that it has been strictly adhered to in its procurement processes**;
- For any exogenous factors, expenses incurred under extraordinary circumstances consideration shall be given to spreading such expenses over a number of years;

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MYPD CRITERIA

- Only **efficient** human resources will be allowed;
- Corporate social investment and expenses on charitable donations and broad social development activities. However, they cannot be included as qualifying (regulated) expenses and would need to be funded from below the bottom-line or by the shareholder;
- Expenses on advertising **not related to the core business** of supplying electricity will also be disallowed;
- Costs of special characters that are allowable in the revenues include primary energy, research and development costs for regulated activities, transmission service quality incentives, transmission supply quality incentives or system minutes, distribution service incentives and Energy Efficiency and Demand Side Management (EEDSM).

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ESKOM INTEGRATED REPORT AND ANNUAL FINANCIAL STATEMENTS 2018

- It is mentioned in the Integrated Report that Eskom's external auditors (SizweNtsalubaGobodo Inc) issued a **Qualified Audit**.
- The Independent auditor's opinion is summarized as follows:
 - Prior-year restatement due to non-accounting for assets built by customers.
 - Uncertainty that may cast significant doubt on the group's ability to continue as a going concern (similar to emphasis of matter).
 - **Incomplete reporting of irregular expenditure.**
 - No reporting requirement at half-year.
 - **Incomplete reporting of irregular expenditure, fruitless and wasteful expenditure and losses due to criminal conduct.**

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ESKOM INTEGRATED REPORT AND ANNUAL FINANCIAL STATEMENTS 2018

- The report states that the **irregular expenses** in 2018 amounted to **R19.6 billion**.
- It is also mentioned that **60%** of incidents of irregular expenditure relate to **administrative non-compliance**.
- It was further mentioned that R10 billion worth of condonations of the R19 billion are awaiting approval.
- Invoiced municipal arrear debt (including interest) has increased over the 12-month period by **R4,2 billion**, which amounts to an increase of **44%**, **a total of R13.6 billion**.
- It should also be mentioned that the arrear debt (including interest) in terms of invoiced **Soweto SPU** (Small Power Users) has increased to **R12 billion**, with a payment level of 15%.

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ESKOM INTEGRATED REPORT AND ANNUAL FINANCIAL STATEMENTS 2018

- A very important fact is that the materiality of the audit amounted to **R25 million**.
- It is therefore **unlikely** that during the audit any samples below R25 million were tested for compliance.
- Reasons for irregular expenditure is provided. These *inter alia* include the following:
 - Use of sole source.
 - **Tender process not adhered to.**
 - Incorrect classification as emergency procurement.
 - **Tender process not followed and insufficient delegation of authority.**
 - Modifications exceeding allowed amounts.
 - **Incorrect tender process applied.**
 - Tax clearance certificates. This aspect revolved more around foreign vendors.
 - **Contracts not in accordance with National Treasury guidelines.**
 - **Commitments made before approval.**

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FINAL REPORT: FORENSIC INVESTIGATION INTO VARIOUS ALLEGATIONS AT TRANSNET AND ESKOM

- “1.15. Eskom officials gave Tegeta **preferential treatment** in that they were allowed to commence coal deliveries without any confirmation by Eskom that Tegeta’s coal was compliant with CSA’s coal quality requirements”;
- “2.2. Eskom management **prejudiced Glencore by fining OCM R2.1 Billion for supplying allegedly poor-quality coal**, which amounted to the **abuse of a position of authority**, a breach of trust, and a **violation of a legal duty** or a set of rules in terms of the **Prevention and Combating of Criminal Activities Act.**”
- 2.3. Eskom was **prejudiced by the reduction** of a R2,1 Billion penalty imposed for supplying allegedly poor coal quality which amounted to the abuse of a position of authority, a breach of trust, and a violation of a legal duty or a set of rules in terms of the Prevention and Combating of Criminal Activities Act.

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ESKOM INTERIM FINANCIAL STATEMENTS 2018/2019

- It was mentioned in Eskom integrated report and Annual Financial statements 2018 that the invoiced municipal arrear debt (including interest) has increased in 2018 by **R4,2 Billion to R13.6 Billion**. With the interim report only reporting on half of the financial year, the municipal debt has already increased to **R17 Billion (R3.4 Billion difference)**.
- Eskom debt has dramatically increased from **R389 billion** in March 2018 to more than **R419 billion** in September 2018.

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THE BIG QUESTION

- Does Eskom's performance, as mentioned above warrant such a steep electricity tariff increase?

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BORBET CASE ANSWER

The Borbet Judgment made it clear in paragraph 110 that NERSA's task "is to maintain a **balance** between Eskom's sustainability as a business and **reasonable** tariff stability as well as to appropriately allocate commercial risk between Eskom and its customers. That is not to say that NERSA is obliged to approve variances due to **maladministration** on Eskom's part.

Paragraph 119 continues: "I appreciate that the South African taxpayer and electricity consumer are exhausted by the constant historical failures by ESKOM. Whether ESKOM is penalised by NERSA through the imposition of a fine or whether a request a tariff adjustment is granted or denied, the taxpayer and the consumer ultimately appear to be the ones who bear the financial burden. ESKOM is a strategic national asset. What is **required** from it is **optimum efficiency** and **accountability**. **NERSA** and its sole shareholder, the government, are tasked to ensure that **result**."

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CONCLUSION

- This submission aims to ensure that imprudent costs/expenditure incurred by Eskom is not passed on to consumers by way of Tariff increase or RCA applications.
- AfriForum believes that prudent decision-making goes further than pure lawful decisions. Its is a higher bar to pass.
- Does Eskom meet the standards set out by the Constitution, PMFA, MYPD and other legislation?
- That NERSA fulfils its mandate by regulating the management of energy and its tariffs by using mechanisms and remedies at its disposal to ensure efficient, economic and effective use of resources, as set out in the Constitution.
- Advocating for the efficient, effective and prudent decentralisation of generation, distribution and transmission activities from Eskom to independent power producers, distributors and transmitters.