City Power Presentation on Eskom MYPD4 Revenue Application

February 2019

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Regulatory Asset Base

RAB

- Eskom was allowed to base RAB for year FY18/19 on the NERSA approved closing RAB for MYPD3,
- Eskom application on pages 50-55 of 115 does not seem to provide appropriate basis for opening RAB for MYPD4,
- The NERSA approved Eskom RAB (MYPD3) valuation was based on NERSA adjustments to Eskom DRC Valuation report as at 31 March 2012 in terms of which DRC for FY201516 was R603b, if Eskom four years later has a valuation (R853b) that is 41% higher it assumes an annual average escalation of at least 10% since last NERSA valuation of Eskom RAB,
- The application is however silent on how valuation between FY201516 and FY201920 increased by a further 43% to R1222b.
- As a result Eskom on average applied for annual average depreciation over the MYPD3 cycle that at R71b will be almost three times current levels of R25b,
- Allowing Eskom RAB as applied would not be prudent as it will be self serving,

RAB-Gx

- As per Eskom application (p106of 131) valuation for Gx RAB increases by at least 57% to R1 001b which translates into even higher annual average escalation rate of 14% of the four years,
- The Gx RAB application also does not split Capex between new asset creation and other capex which is not to be considered for purposes of Gx RAB,
- It is therefore not possible to make any further meaningful assessment of Eskom Gx RAB application,
- Eskom on p114 of its AFS FY201718 provides DRC valuation of R863b which though higher is consistent with NERSA DRC valuation at the end of MYPD3 of R717.513b,
- It would therefore be prudent for NERSA to based on an appropriate international benchmark index, escalate MYPD3 RAB while allowing itself sufficient time to independently verify Eskom DRC valuation as per its latest AFS.

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Coal Procurement Strategy

Primary Energy: Coal Procurement Strategy

- According to Figure 14 on p66 of 115 Eskom plans to source about 40% of its annual coal procurement on short term contract, about half of which from unknown source, presumable at yet unknown price,
- Eskom projects its coal cost to increase by 18% during current financial year and by 16% in Year 1 of MYPD4, yet the countries CPI averages around 5-6%,
- Eskom on p42 of 131 attributes the 16% increase to increase volume of coal from short-term and unknown coal,
- The application on p53 of 131 suggest that cost plus and long term contract have well defined escalation clauses (i.e. 8% p.a.), implying price spikes are entire attributable to short-term contracts,
- It is therefore not clear how Eskom intents to achieve only 3%-5% growth in coal price over remainder of MYPD4,
- NERSA should therefore ensure appropriate pricing signal to encourage Eskom toward a coal procurement strategy to inspire price and supply stability.

Energy Utilisation Factor

Primary Energy: Energy Utilisation Factor

Eskom Definition EUF is **a measure of the degree to which the available energy capacity** of an electricity supply **network is utilised**. It reflects the ratio of actual **energy produced (not availability)** against the energy that the **full available capacity** could have produced *(source: Eskom Integrated Report Y17/18 p47 of 80)*

- According to Eskom its EUF in recent years has been as high as 93%, however forecasted to decline mainly due to displacement by renewable IPPs
- Eskom Generation application in Table 9 (p30 of 131) forecasts an EUF ranging between 68-70%, which **indicates available but idle capacity**
- Removal of coal plant should therefore not result in additional use of OCGT as proposed by Eskom (in the Soweto Hearing)
- NERSA has the opportunity to reduce OCGT usage by allowing Eskom to improve on its EUF.

Other Primary Energy Cost

Other Primary Energy Cost

- The projected increase in water cost of 26% in current financial year is unjustifiably high and should be limited to levels as approved by NERSA, for purposes of MYPD4
- NERSA should otherwise align increase of water cost to the price path as envisaged by Department of Water Affairs and Forestry
- Production by OCGT to be limited levels of R120m (118GWh) achieved in FY1718
- IPP cost to be allowed for Rounds 3.5-to-4.5 to be aligned to envisaged commercial operation date (COD)
- The projected increase of 37% in the price of electricity imported for the current financial year is unjustifiably high and should be limited to appropriate levels

Operating Expenses

Operating Expenses

- In response to previous NERSA decision Eskom in FY1718 reduced its opex by as much as 17%

- The increase for MYPD4 should therefore be limited to a maximum of projected CPI

- Similarly Eskom in FY1718 managed to reduce its actual arrear debt impairment to R528m only, NERSA should therefore limit such impairment for MYPD4 to encourage Eskom to further management of its debtors book

Conclusion

Conclusion

- Scope for NERSA to base it decision on indexing RAB for MYPD3 while allowing it self time to assess Eskom DRC as published in Eskom FY1718 AFS,
- NERSA to limit increases allowed for coal procurement to inspire Eskom to come up with a coal procurement strategy to ensure greater predictability of price and supply stability,
- Opportunity for NERSA to reduce OCGT usage to 118GWh p.a. by increasing EUF by 1-2 percentage points,
- All other primary energy cost including IPPs, OCGT and water cost to prudent levels,
- To ensure gains Eskom made in greater efficiency in operating cost is further encouraged.

Thank you

City Responses

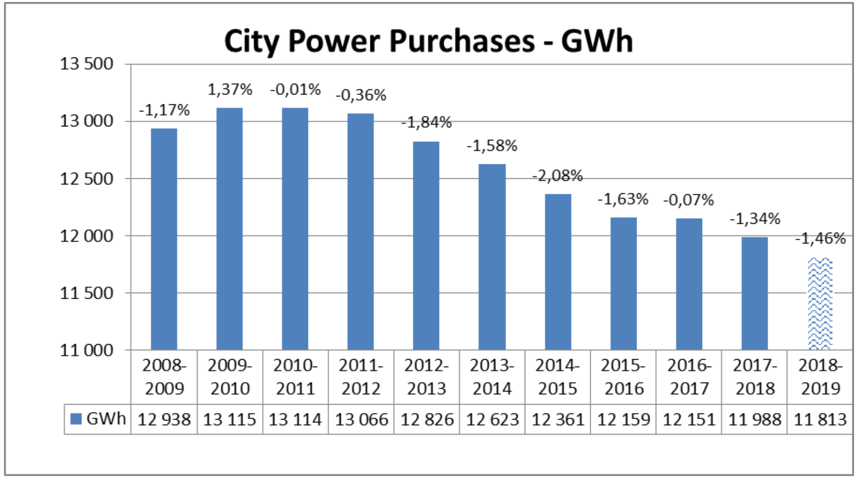
City Power Responses

- A Reseller Tariff implemented by reducing tariff charged to resellers in order to ensure that end customers are not disadvantaged
  - Resellers who participate in City Power program are allowed to charge customers only NERSA approved tariffs
  - City Power benefits by reduced operating cost while customers are not disadvantaged
  - City Power continues to bring awareness (through media, by-laws, etc.) around this issue to electricity end users in order that any opportunistic behavior through resale of electricity eliminated.

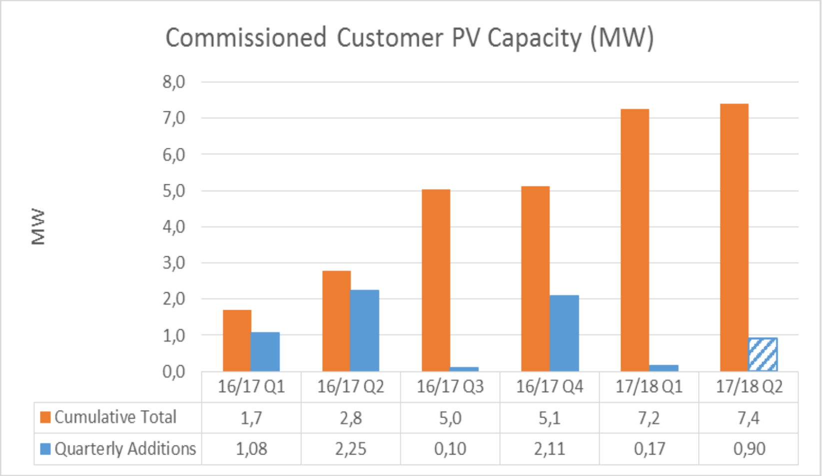
- Inclining Block Tariff (IBT) as prescribed limit municipal ability to charge flat tariff,
  - Charging customers only fixed charges R/m will lead to inefficient use of electricity

- Eskom owed by Municipalities – While City Power accounts are under current (i.e. within 30 days), it is rather Eskom that owes the City of Johannesburg on electricity services

Embedded Generation



- City Power bulk purchases peaked at 13 115GWh in FY09/10
- A 1.46% contraction is still expected for FY18/19



- City Power has NERSA approved tariffs for small scale embedded generators
- In FY16/17 City Power reported 5,54MW of Photovoltaic generation connections

City Power continues to explore all options that will enhance diversity in energy, particularly those that are carbon efficient!