

2018

## **EIUG Comment on Eskom's RCA Applications 2014/15, 2015/16, 2016/17**

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The Energy Intensive User Group of Southern Africa (EIUG) is dedicated to the promotion of the interests of energy intensive users in South African Industry.











### KEY FOCUS AREAS:

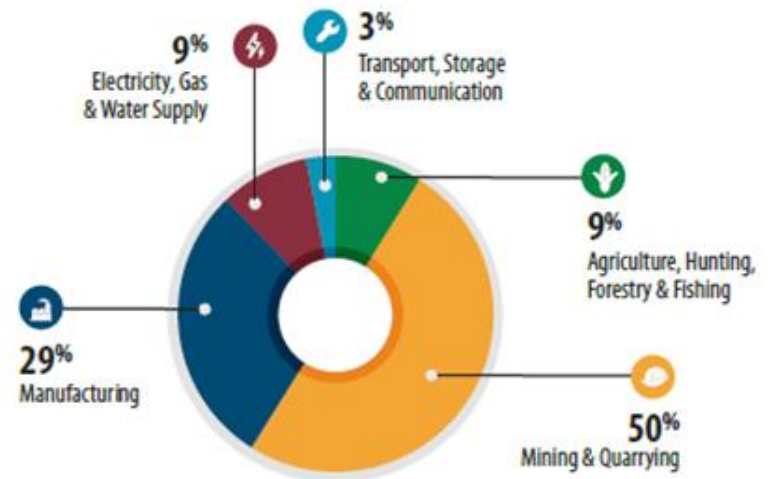
- Affordable and Sustainable energy pricing
- Security of Supply
- Quality of Supply

Established in 1999, the EIUG is a voluntary, non-profit association of energy intensive consumers whose members currently account for over 40% of the electrical energy consumed in South Africa. Our members collectively contribute about 22% to the GDP of South Africa.

The EIUG has significant technical expertise on energy matters. It is a respected and non-partisan organisation dedicated to working towards a sustainable energy supply industry.

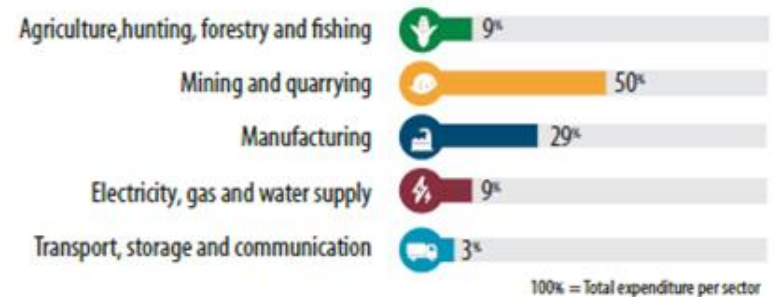
No of Companies			31
No of Employees Worldwide		1 038 416	
No of Employees in South Africa		657 984	
South African operations turnover		R684 724 000 000	
%South African GDP		22,0% GDP	
Energy Usage (In South Africa)		146 825 121 Mwh	
% Members with EE Projects		58%	

### CURRENT MEMBERS CONTRIBUTE TO THE FOLLOWING SECTORS:



There is no sector limitation for membership and we try get an as diverse array as possible

### ELECTRICITY COST AS % OF ANNUAL EXPENDITURE



# KEY MESSAGES

- EIUG member companies cannot absorb any further price increases while remaining in business;
- The EIUG analysis established that **only up to R40.5 billion cost-recovery could be allowed in terms of the RCA rules**. However NERSA must determine whether these costs (i.e. covering the R40.5 billion) have been prudently and efficiently incurred because EIUG does not have adequate information to make this assessment;
- EIUG's view is that, in making the decision, **NERSA should also consider the capital expenditure overspent by Eskom (R40.9 billion), to ensure that Eskom is not permitted to pass-through any costs outside the RCA rules;**
- The **capital expenditure overspend** should also not be included in Eskom's RAB going forward, in line with the Electricity Pricing Policy.
- NERSA must exercise its regulatory discretion to *“ensure that the interests and needs of present and future electricity customers and end users are safeguarded and met”* and *“facilitate a fair balance between the interests of customers and end uses, licensees, investors in the electricity industry and the public”* (Sections 2 (b) and (g) of the Electricity Regulation Act 4 of 2006 respectively).

# PURPOSE

The following questions were received from the NERSA panel. This presentation seeks to answer these questions.

1. Can the EIUG elaborate more on its recommended R40.5 billion with reasons?
2. If EIUG understands the RCA rules, what is the reasoning behind juxtaposing the capex overruns against the R60.7 billion?
3. If EIUG recommendation is that NERSA not to allow all the regulatory clearing accounts, what is the suggested methodology going forward?
4. Previously, EIUG did not allow the use of diesel during the load shedding to be a passed through cost. Why is EIUG more tolerant on IPPs?
5. How does the EIUG energy consumption profile in the past few years compares with that of Eskom's? If the variance is significant how can the two institutions work together to flatten it?
6. What is the recommended optimum and cost effective energy mix from EIUG perspective?
7. Can EIUG prove that Eskom has moved funds elsewhere without NERSA's approval?

# SUMMARY OF RCA ANALYSIS

RCA (R'm)	2014/15 RCA Application	Recommended 2014/15	2015/16 RCA Application	Recommended 2015/16	2016/17 RCA Application	Recommended 2016/17	TOTAL RCA Application	TOTAL Recommended
Revenue	8 787	6 150	15 578	10 904	20 016	13 010	44 381	30 064
Coal	574	-1 114	3 258	-2 499	-359	-2 312	3 473	-5 925
OCGT's	1 944	1 944	689	689	-1 259	-1 539	1 374	1 094
Other PE	1 355	1 355	728	728	722	722	2 805	2 805
Local IPP's	4 346	4 217	620	584	2 452	1 973	7 418	6 774
Int. Purchases	3 299	3 299	3 567	3 567	2 282	2 282	9 148	9 148
Environ Levy	-683	-683	-1 180	-1180	-1 404	-1 404	-3 267	-3 267
Nuclear decom.	83	83	83	83	83	83	249	249
DMP	-379	-379	248	0	194	0	63	-379
CECA	91	0	332	0	636	0	1 059	0
IDM	-149	-149	-368	-139	0	-229	-517	-517
Opex	-528	-528	-134	-528	0	394	-662	-662
SQI	236	236	318	318	343	343	897	897
Inflation	209	209	-152	-152	162	162	219	219
<b>TOTAL</b>	<b>20 924</b>	<b>14 640</b>	<b>23 587</b>	<b>12 375</b>	<b>23 868</b>	<b>13 485</b>	<b>66 640</b>	<b>40 500</b>

*It must be noted that some of the amounts require verification from NERSA.*

# SUMMARY OF THE REVENUE ANALYSIS

RCA (R'm)	2014/15 Application	Recon 2014/15	2015/16 Application	Recon 2014/15	2016/17 Application	Recon 2014/15	Total Application	Total Recon
Revenue	8 787	6 150	15 578	10 904	20 016	13 010	44 381	30 064

- The variance between the forecasted sales and actual sales over the last 10 years of the MYPD has increased significantly, indicating that the ability of Eskom to forecast sales is inadequate and must be reviewed by NERSA.
- The slow-moving economic growth, energy savings, strikes, price elasticity of demand, closure of mines, smelters and other businesses have contributed to the decline in sales volumes.
- **However, the unavailability of electricity supply from Eskom, load shedding by Eskom, load curtailment by Eskom and higher electricity prices were significant drivers behind the lack of growth and reduced electricity sales.**
- Therefore, the EIUG is of the view that Eskom should only be compensated for the fixed costs portion of the revenue variance (i.e. operating costs (excluding primary energy costs which are evaluated separately), depreciation and returns). Based on the MYPD applications the fixed costs are estimated to be 70% of the total costs.
- **NERSA should accurately establish the fixed costs portion of the electricity sales and further align the claw back to the actual costs.**

# SUMMARY OF COAL ANALYSIS

RCA (R'm)	2014/15 Application	Recon 2014/15	2015/16 Application	Recon 2014/15	2016/17 Application	Recon 2014/15	Total Application	Total Recon
Coal	574	-1 114	3 258	-2 499	-359	-2 312	3 473	-5 925

- NERSA approved coal burn volumes compared to Eskom actuals shows that in all the 3 years under consideration the coal burn volumes were less than the amounts assumed in the MYPD3 decision, which is consistent with the lower sales volumes.
- However, the average costs were higher than Benchmark costs indicating that Eskom used more expensive coal than the Benchmark average. The coal price increases in 2015/16 from the approved R311,2/ton to R378,8/ton (i.e. more than 20% increase) have not been explained by Eskom. The reasons for purchasing expensive coal is attributed to the delay in the commissioning of Medupi and more expensive coal being sourced from other collieries. Both these reasons are within Eskom's control and the increase should be limited to the maximum increase of 10%
- The control of coal costs is within Eskom's mandate and the methodology should limit the opportunities for Eskom to purchase coal at higher prices than those approved.



# LOCAL IPPs AND COGENERATION

Local IPP's and co-generation	2014/15	2015/16	2016/17	TOTAL
RCA application (R'm)	4 346	620	2 452	7 418
Disallowed amounts (R'm)	129	35,8	477	641,8*
Allowed amounts (R'm)	4 217	584,2	1 975	6 776,2*

IPP COSTS

\*Error found post written submission

The additional amount that was contracted by Eskom (including the ancillary service adjustments) to meet the demand from these contracts should be allowed, **subject to verifications by NERSA that the payments were in accordance with the agreed contractual amounts.**

To NERSA's question no 4: The EIUG previously advocated for allowing only the coal equivalent costs for extraordinary OCGT operation since the root causes for the extraordinary amounts of diesel burned were under Eskom's control and should have been prevented.

However, **the MTPPP and STPPP pass through should be allowed since the programs followed due process with NERSA support.** The PPAs were signed with NERSA's consent and Schedule 2 amendments of the relevant generation licences were approved by NERSA.

# OTHER ISSUES

The following points relate to questions 5, 6, and 7 raised by the NERSA panel (slide 5 above):

5. Some of the reasons provided by Eskom for the variance in the consumption profile from the MYPD3 forecast, such as sluggish economic growth are correct. However, the key contributors to the variance were the unavailability of electricity supply from Eskom, load shedding by Eskom, load curtailment by Eskom and higher electricity prices.

The EIUG is committed to working closely with Eskom (within the confines of competition law) to ensure that Eskom's load forecasts are more realistic.

6. The EIUG needs internationally competitive electricity prices and to achieve it the lowest cost energy mix is required. Given South Africa's renewable resources all competent modelling seems to indicate that renewables and flexible back-up generation from gas will provide the lowest cost mix going forward. The pace of future roll out of new capacity must also be aligned with more realistic demand growth forecast, since over-capacity is an expensive luxury.
7. With regards to concerns raised on the Capital Expenditure Clearing Account (CECA) – The EIUG analysis indicates that there was over-expenditure on the generation capital and under-expenditure on the transmission and distribution capex suggesting that Eskom did not follow the MYPD3 approved capital expenditure projects. Eskom in their application also state that this was caused by their “capital expenditure reprioritisation process” but provide no evidence to suggest that this deviation was approved by NERSA.

# CONCLUSION

- NERSA must exercise its regulatory discretion to balance the interests of customers and Eskom.
- NERSA must determine whether costs submitted by Eskom have been prudently and efficiently incurred.
- DOE, NERSA and Eskom have not provided any form of price path certainty to enable economic growth, development and job creation. This price certainty is critical to our members to plan for growth.

**Re a leboha**

**Ro livhula**

**Siyabonga**

**Ha khensa**

**Enkosi**

**Siyathokoza**

**Thank you**

**Dankie**

**Re a leboga**