

Eskom engaging in creative accounting

Happy Khambule
Greenpeace Africa
hkhambul@greenpeace.org

7 July 2017

Eskom



- Eskom's important role in South Africa's energy landscape cannot be underestimated.
- **We believe that Eskom's level of accountability and transparency needs to be significantly increased in the interests of social, environmental and economic justice.**
- **We therefore strongly object to Eskom's application for a tariff increase.**

The situation: our point of departure



Can Eskom actually apply for a one year revenue application outside of a multi-year revenue application?

There has been no revision of the MYPD methodology to facilitate a one year application. This in itself is a gross extension of the regulator's discretion.

Even though NERSA's decision to grant a process deviation is not explicitly set out in MYPD, it is important to note that the MYPD methodology is for determining tariffs for periods exceeding a year.

The situation: our point of departure



- This submission is informed by:
 - The 2016 MYPD methodology
 - NERSA's Record of Decisions on Eskom condonation application
 - Previous Eskom applications not limited to the RCA application and the MYPD selective reopener.
- Also of importance are questions concerning:
 - the Eskom CSP plant and reasons for its omission as part of the production plan post 2018/19
 - Governance issues

Governance



- Eskom is in the news for all the wrong reasons
- This is mainly due to dodgy deals that have been signed, in many cases with costs amounting to billions eg Dentons, McKinsey.
- We cannot ignore that it has recently been reported that Eskom's deviations from public procurement regulations amounted to a massive R37.6 billion in the 2016/17 financial year.
- The South African public is being penalised for a lack of accountability.
- It is inconceivable that Eskom should be rewarded for bad governance and bad decision making with the tariff increase.
- We have to stop and examine the information that Eskom is putting forward not in isolation, but in context.
- We must look at how the utility is behaving, and the decisions it has taken.
- **Greenpeace believes that point is now, and urges NERSA to seriously apply its mind, in terms of what are justifiable expenses, and what is the result of profligate decision-making.**

The basis of Greenpeace Africa's submission



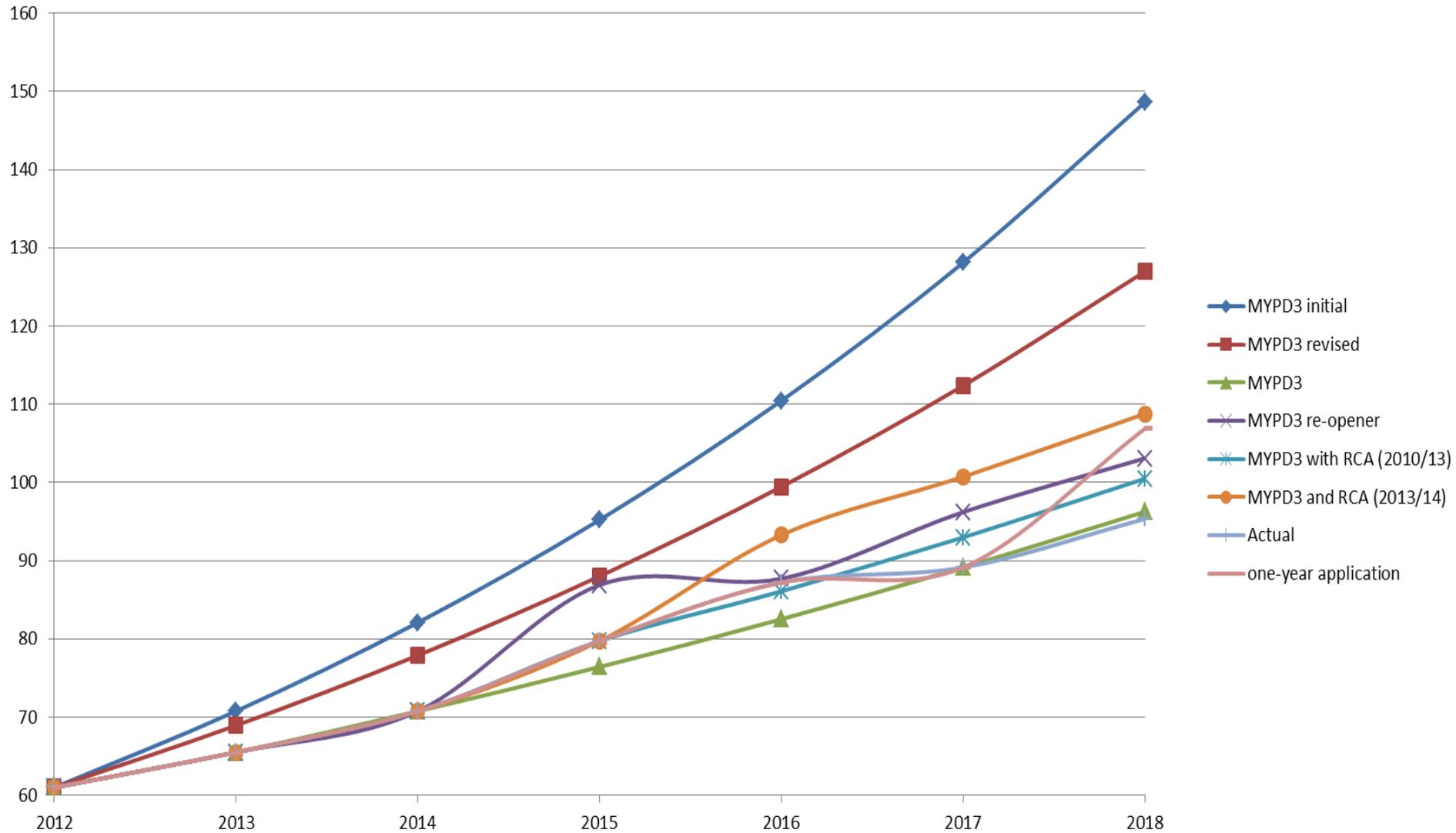
- Eskom's level of accountability needs to be significantly increased in the interests of social and environmental justice. The utility's application of the MYPD methodology is no exception.
- Greenpeace Africa strongly objects to Eskom's application for a tariff increase. We base this objection on the following issues in Eskom's application:
 - Eskom's price path
 - Return on assets
 - The Renewable Energy Independent Power Producer Procurement Programme (REIPPPP)
 - Primary energy costs
 - Revenue recovery
 - Reduced demand for electricity
 - The size of the proposed tariff increase
 - The growth of IPPs
 - Generation performance
 - The 'Energy Wheel'

Eskom's price path



- Eskom seeks to attain a specific price path.
 - This price (tariff) path is that of a trajectory that achieves returns or a year-end tariff based on the initial 3rd Multi-Year Price Determination period for 2013-18 (also known as MYPD3) 16% application.
- The revenue shortfall from the MYPD3 period is the basis for Eskom's continued persistence.
Eskom is acting in bad faith.
- Some of the reasons for the tariff increase offered by Eskom are incoherent.
 - STCs have not received a decrease in electricity prices for well over a decade.
 - Since the implementation of the MYPD methodology in 2006 electricity prices have been increasing.
 - The nature of the MYPD creates conditions where tariff increases have a compounding effect.
 - Even though the current applicable 2017/18 2.2% increase was below the 2013-2018 8% average increase, the 2.2% increase pushed the real price of electricity upwards . This means there has been no reprieve for consumers.
- Furthermore the suggestion by Eskom that prices have universally started at an artificially low base is disingenuous.

Eskom's price path

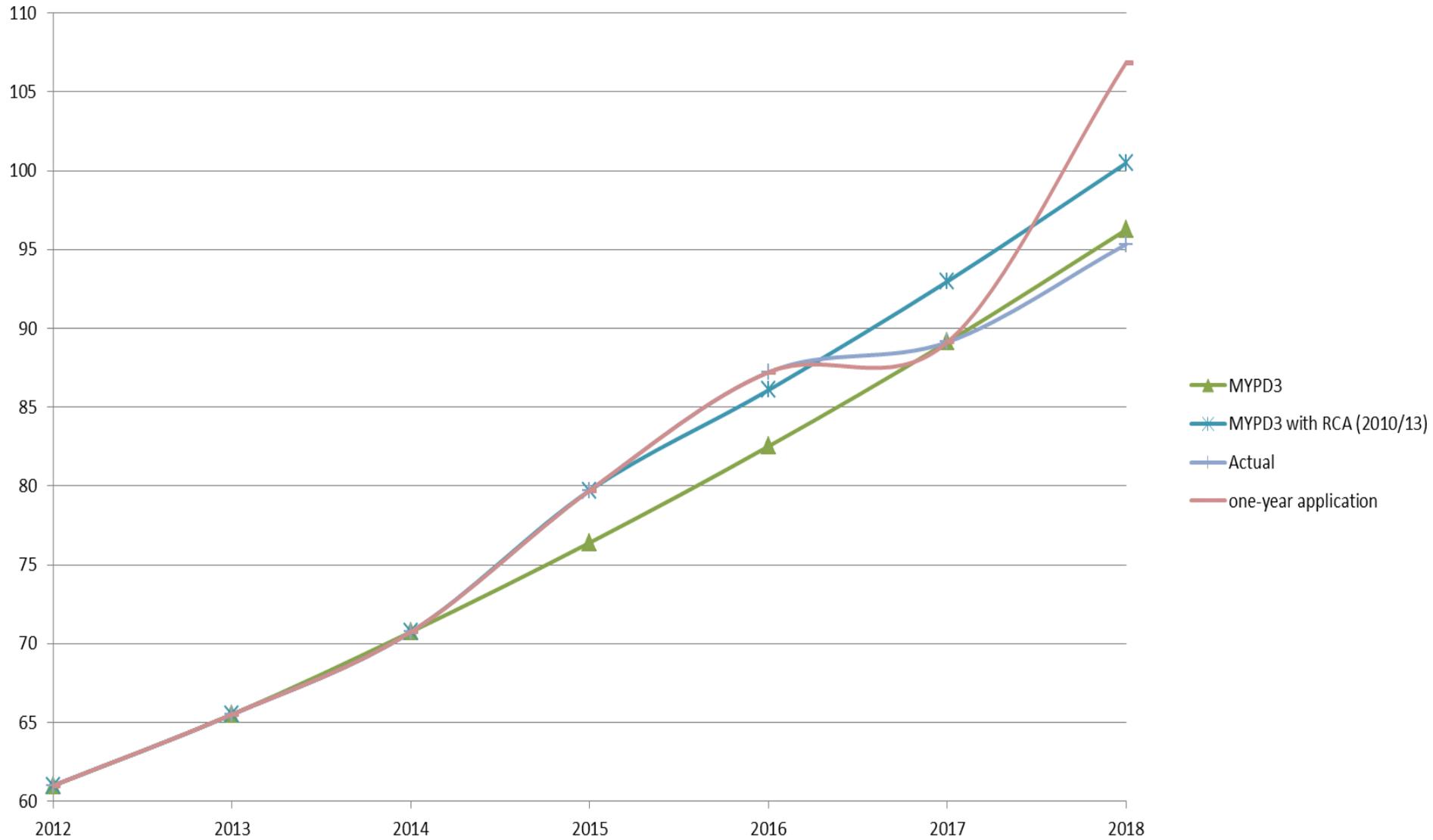


Eskom's price path



- Eskom has communicated through its executives that it thinks of tariffs as achieving a specific price path:
 - Twitter: @koko_matshela 2017/05/24, 10:04pm,
https://twitter.com/koko_matshela/status/867471473807642624
 - Eskom does not have a consideration of affordability for consumers, nor does it work with reality.
- To illustrate this, NERSA must consider that Eskom has a history of using the MYPD to claw back under-recovery without apportioning under recovery to specific customer groups.
 - As each customer group has a set of applicable prices, Eskom has repeatedly used STCs as a means to recoup revenue that was under-recovered from other customer groups.
 - From the onset, allowable revenue as a result of the decision on the 2016 RCA RoD by NERSA, should have distinct application as it applies to each customer group be it STCs, NPAs, IS.

Eskom's price path



The Renewable Energy Independent Power Producer Procurement Programme (REIPPPP)



- Eskom has included costs for REIPPPP windows that have since been suspended or are pending renegotiation since it refused to sign Power Purchase Agreements (PPAs).
- These costs should not be allowed to be passed onto the consumer. The fact that these costs are listed illustrate the Eskom is engaging in creative tactics in order to necessitate a tariff increase.
- Eskom's approach to renewable energy is nothing less than a propaganda campaign against renewable energy, with the utility using every opportunity to mislead the public on the impact of renewable energy, and this application is no different.

Revenue recovery



- There are a number of ways in which Eskom has undoubtedly misrepresented the most important component of the application.
- Eskom misleads the reader - and by extension the regulator - by stating that the primary source of its revenue is international consumers, followed by NPAs and then STCs.
- Even though this is anecdotal it serves to illustrate Eskom's bad faith in the application.
 - It is in fact the other way around, a large portion of Eskom's revenue and demand comes from STCs, and in fact, STCs are the single largest consumer of Eskom's service/product.
 - It is imprudent to penalise customers due to Eskom's mismanagement and inability to secure preferential NPAs.

Reduced demand for electricity



- Eskom cannot be allowed to continuously overestimate the demand for electricity, and use this as a basis for their MYPD applications.
- In reality, the demand for electricity in South Africa is below projections, because the rapidly increasing price of electricity is unpredictable and unstable, and yet another above-inflation tariff increase will not inspire confidence. Eskom is seeking to penalise all consumers, particularly the most vulnerable and captive STCs.
- It is clear from the MYPD period that there is a lower demand for electricity from STCs, and many of the classes of STC consumers that aided cross-subsidisation are beginning to defect from the grid or are exploring a mix of sources to realise energy security, since Eskom unreliability seems to be on the rise.
- Should NERSA allow a further tariff increase more people/STC consumers will defect from using Eskom electricity as their sole source of electricity.

Reduced demand for electricity



- If NERSA were to increase the tariff, the regulator should also instruct Eskom to factor in grid defection as an assumption or cost driver or as a mitigating factor for increases. With this in mind, it is clear that a tariff increase in current conditions is contrary to the key objectives of the MYPD namely:
 - 2.2.1 to ensure Eskom’s sustainability as a business and limit the risk of excess returns;
 - 2.2.2 to ensure reasonable tariff stability and smoothed changes over time consistent with socioeconomic objectives of the Government;
 - 2.2.3 to appropriately allocate risk between Eskom and its customers;
 - 2.2.5 to provide a systematic basis for revenue/tariff setting; and
 - 2.2.6 to ensure consistency between price control periods.
- The manner in which Eskom presents the information in the application makes clear that **the utility seeks to unduly discriminate between customer categories by placing an unfair burden on STCs because Eskom is not applying its mind during NPA and international sales negotiations.**

The size of the proposed tariff increase



- The proposed 2018/19 price is very substantial, the resulting price shock will be significant.
- The initial 9.4% impact as a result of rebasing of sales volumes is riddled with a flawed interpretation of the methodology. There is no interpretation of the methodology that affords Eskom the provision to institute rebasing of sales volumes.
 - In fact, Eskom is entitled - as per s6.1.5 - to have an application that encompasses sales volume forecast that accurately reflect the current conditions of the market at the time of the application **and should take into account the most recent actual volumes.**
 - Nothing in the provision implies that the sales volumes should be based on previous sales volumes in relation to previously assumed/projected volumes. This means the notion of **rebasing is baseless and nonsensical and that NERSA cannot grant an increase on the grounds of rebasing.**
- The methodology is explicit in what constitutes assumptions in sales volumes. This is the recent actual volumes - in this case 2016/17 and the current conditions of the market - and this would also entail demand as well as the forecast of year-end volumes as they are at the time of the application.

The growth of IPPs



- The growth of IPPs is listed as the second contributor to the price increase. It is clear that the application is distorting and misrepresenting the current state of play.
- The REIPPPP impact is and should only be limited to bid windows 1-3. Bid windows 3.5 and 4 are pending renegotiation and/or judicial review, whereas bid window 4.5 has been cancelled in its entirety by the DoE.
- Therefore the price impact, if it has not been already internalised. Means the impact of IPPs should remain unchanged, in actual fact with the decreasing use of STPPP and MTPPP, the impact of this cost item should be a decrease of the tariff.
- **Thus, NERSA cannot grant an increase on the basis of the growth of IPPs.**

Summary of submission



- In order to reiterate the incompatibility of a tariff increase and the objects of the methodology, Greenpeace would like to highlight the following:
 - The nature of the MYPD creates conditions where tariff increases have a compounding effect.
 - Eskom thinks of tariffs as a way to achieve a specific price path. Issues of affordability are ancillary and Eskom does not have a consideration of affordability for consumers, nor does it consider reality.
 - NERSA must consider that Eskom has a history of using the MYPD to claw back under-recovery without apportioning revenue under-recovery to specific customer groups.
 - It is inconceivable that consumers have to pay for a return on assets that are under construction and completed, as well as pay for the depreciation of the very same assets. The manner in which Eskom is treating these two allowable revenue components categorises them as excessive.

Summary of submission



- Should NERSA allow a further tariff increase more people/STC consumers will defect from using Eskom electricity as their source of electricity. If NERSA were to increase the tariff, **the regulator should also instruct Eskom to factor in grid defection as an assumption, cost driver or as a mitigating factor.**
- **Nothing in the provision implies that there is a basis for the rebasing of sales volumes.** This notion is baseless and nonsensical.
- The REIPPPP impact is and should only be limited to **bid window 1-3. Bid windows 3.5, 4 and 4.5 are pending renegotiation and judicial review and are not applicable for the application period.**
- Eskom in no way sees a correlation between reduced demand and improved plant availability, nor does Eskom factor in the price of electricity as a continued deterrent to continued use. This means that **in Eskom's thinking, the price of electricity has no impact on the utilisation thereof.**

Recommendation



Given all of the above, Greenpeace believes that NERSA should reject Eskom's application for an increase.

NERSA must pay particular attention to the application of the MYPD methodology and the representation of fact in the Eskom application.

It is painfully clear that a tariff increase in current conditions is contrary to the key objectives of the MYPD methodology.