Eskom’s MYPD4 application

5 February 2019

Helen Suzman Foundation

The facts

Eskom

- is faced by stagnant (or even declining) demand
- faces an increase of its primary energy costs way above inflation
- has a workforce which is one-third overstaffed
- has capital project cost overruns amounting to over R100bn
- has to borrow to service its debt obligations
- has shown reluctance to integrate renewable power into the grid (whilst the draft IRP shows that renewables are now cheaper than all alternatives)

The facts, continued

- is applying for an annual tariff increase of 15% over three years, but if we include the already approved RCA application for Years 2, 3 and 4 of MYPD3 and if we were to assume an annual recoupment of 25% of the MYPD3 RCA application for year 5 as from 2020/21, then we arrive at an average annual increase for consumers of 17% over three years.

The facts highlight two overriding issues

1. Eskom’s business model is out-of-date
2. The application of the MYPD methodology has become problematic

Issue 1 - Eskom’s business model

- Eskom’s business model is out-of-date as it addresses neither its current challenges nor the situation which is expected over the medium-term. The current three-year application does not refer to its medium-term strategy.
- NERSA is therefore placed in a very difficult position: how can it be expected to take a medium-term view in these circumstances?
- One way of dealing with this would be for NERSA to make a one-year tariff decision and to make further decisions dependent on the presentation by Eskom of a coherent medium-term strategy

Issue 2 - the MYPD Methodology cannot deal with this situation

- Essence of the MYPD methodology: allowable revenue provides for the reimbursement of Eskom's costs and a return on assets (plus depreciation).
- The problem is that Eskom's asset base has increased dramatically over the past few years, including cost overruns of more than R100bn in projects that Eskom decided to manage itself. What assurance does NERSA have that the valuation of Eskom's asset base in the current application is reasonable, as the last independent valuation of the asset base was undertaken in 2016?
- In its application, Eskom maintains that the return on assets (plus depreciation) must match its debt service commitments - but there is no logical basis on which these two separate concepts have to be the same - and Eskom even accepts a R50bn cash shortfall in its application, as it realises that the full amount is not defensible.

Issue 2 continued - the MYPD Methodology cannot deal with this situation

- The problem of having your income formula boosted by the return on a high asset valuation is compounded on the other side by the fact that demand is stagnant or even shrinking - resulting in an extra-ordinary tariff increase application which is needed to fill the gap.
- What is NERSA to do in these circumstances? One solution would be to ask Eskom to provide a valuation of its current asset base, completed by an acceptable independent expert entity. Once again, a one-year decision can be made now, with further decisions dependent on the presentation of an acceptable asset valuation.

Concluding comments

NERSA would be justified in requesting a coherent medium-term strategy from Eskom and an updated independent asset valuation. As an interim measure, NERSA could consider deciding on a one-year tariff decision.

NERSA cannot deal with the problem on its own - the time has come for Government, as Eskom’s 100% shareholder, to share the financial burden and not to stand idly by in the expectation that the consumer will simply foot the bill.

In any event, the National Energy Regulator Act requires NERSA members to act in the public interest and for every decision by NERSA to be in the public interest. In a stuttering economy, which is growing at far lower levels than assumed by Eskom in its tariff application, substantial electricity tariff increases will place a further burden on consumers and the economy as a whole.