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SALGA Position on Eskom Revenue Proposal 2018/19

Cape Town

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Background

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- SA tariffs are regulated by NERSA) in terms of Electricity Regulation Act of 2006.
- Multi-Year Price Determination (MYPD) governing the Eskom revenue
- The latest 5 year determination (MYPD3) ended on 31 March 2018,
- Eskom required to submit an application to NERSA for the next period.
- NERSA has approved a single year application for 2018/19 financial year.
- The MFMA requires that Eskom must first submit its proposed application to the National Treasury and organized local government before submitting to NERSA.

The Eskom Application

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- Eskom applying for a 19.9% average increase translating to a 1 July 2018 local-authority tariff increase of **27.29%** to municipalities.
- Application is after the NERSA maintained its decision made in 2013 for the 2017/18, to an average 2.2% price increase.
- Eskom claims that the 2.2% average increase in the 2017/18 resulted in the consumers receiving a decrease in electricity prices
- Eskom claims a situation where costs to produce its electricity have been increasing.
- Reporting that sales volumes have dropped,
- Primary energy costs has increased due to a combination of coal mix changes, use of more IPPs and operating costs growth.
- Eskom's claims that the above has been understated in the MYPD3 decision.

Lets go back to MYPD3 Decisions

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- After Eskom's attempts for 16% increases over 5 years, 8% was approved by NERSA
- 5 years later, after asking for double digits and was allocated half of that, Eskom still stands

		2013/14	2014/15	2015/16	2016/17	2017/18	Total MYPD3
Allowed revenue to STD customers tariff based sales before RCA		135 226	147 481	163 179	180 070	198 954	824 909
Allowed revenue tariff based sales RCA	(R'm)			7 085	10 257		
Total allowed revenue tariff based sales after RCA	(R'm)	135 226	147 481	170 264	190 327	198 954	
Forecasted sales to tariff customers	(GWh)	206 412	208 442	213 545	218 194	223 219	1 069 812
Standard average price after RCA	(c/kWh)	65.51	70.75	79.73	87.23	89.13	
Increase in average tariff based tariff increase after RCA (%)		8.0%	8.0%	12.7%	9.4%	2.2%	
Total expected revenue from all customers after RCA(R'm)		143 101	156 057	179 587	198 035	205 214	881 994

SALGA Position

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- **SALGA rejects the 27.29% increase**
- The 27.29% price shock effect on the market is unaffordable and indefensible.
- NERSA MUST NOT , allow Eskom inefficiencies to be passed on to the consumer
- Eskom must stop forecasting higher sales revenue when the reality state otherwise.
- There are several possible savings for the Eskom revenue proposal
- Long term pricing approach must be adopted where prices are gradually increased or amended, allowing for the market and role-players to adjust accordingly.
- Some elements of the application must be relooked since it's a one year application e.g. Depreciation

Summary of Observations

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- IPP forecasting unrealistic and making projections on projects that will not come online, in another two years or so – this is a one year application
- Over half of the tariff increase is based on sales forecasts but Eskom has acknowledged that the sales are dropping, as is the case throughout the industry including municipalities.
- Why would Eskom continue forecasting higher sales and later expect the country to fund these inaccurate forecasts
- The MYPD3 sales forecasts have been higher, yet for all the 5 years they have been hitting lower margins but Eskom continues to claim this on the RCA which we believe has become an abused framework
- Every Eskom increase, is costing the country more to cross-subsidize the poor – especially for municipalities

Summary of Observations

- The Environmental Levy must be retained or reduced to fund the renewable energy IPPs, as it seems customers are paying twice, in the form of the environmental levy as well as the Eskom tariffs for renewables;
- A properly structured plan to phase in increases should be developed to avoid an exorbitant increase in one year
- Eskom has an excess capacity of over 7GW until 2022. Why recapitalize the transmission capacity at a time of excess power?
- Some of the recapitalization can be delayed which can go a long way in reducing the proposed revenue of Eskom – it's a one year application (belts must be tight)
- Costs of running the business should go down if sales and other input costs are going down – the issue of sunk costs is understood but it doesn't mean there can be no innovative and efficient ways to deal with and reduce Eskom sunk costs

Summary of Observations

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- The impact of Eskom's allowance for depreciation in just a one year price period should be revisited.
- We are of the opinion the proposed depreciation amount allocated in just one year is exorbitant (R30bn).
- Eskom needs to restructure itself to become more resilient to a fast changing energy sector and to take on board the transition that is happening globally.
- Currently no systemic changes are mentioned in order to provide affordable electricity.
- Why does the shareholder still maintains taking a 20% share on returns in these tough times?

Potential Savings to be easily achieved on Eskom Revenue Proposal

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- The summary of the table below shows possible savings of just over R26bn from the Eskom application if considered by NERSA.
- Next few slides to illustrate possible savings

Total Revenue Requirement for '18/19 (R'm)	219,514	100.00%
Revenue from NPA & Exports (R'm)	13,309	6.06%
Total Revenue Requirement from STC (R/m)	206,205	93.94%
Forecasted Sale to STC (GWh)	192,953	
Eskom Proposed STC adjustment (c/kWh)	106.87	
Current Average Tariff to STC	89.13	
Eskom Proposed STC adjustment (%)	19.90%	
Potential Saving in RE-IPP cost	7,842	
Potential Saving in PE cost	6,842	
Potential Saving in total Opex	8,817	
Reduction in Environmental Levy	3,426	
Total Potential Savings (R'm)	26,927	
Total Potential Savings Attributable to NPA & Exports	1,633	
Total Potential Saving attributable to STC (R'm)	25,295	
Revenue Requirement on STC after savings (R'm)	180,910	
Revised Average STC Average Selling Price (c/kWh)	93.76	
Revised Average STC Average Selling Price (%)	5.19%	

Potential Savings on IPP Costs

- It is our understanding that Eskom has not signed any new PPA since September 2016. It is therefore unlikely for Round 3.5-4.5 to achieve commercial operation during the application year due to lead time from financial closure to commercial operation being longer than a year.
- The amount of R7451m for rounds 3.5, 4 and 4.5 should for the purposes of the application be disallowed and be deferred to a more realistic commercial operation date outside the one-year application window possibly on a long term pricing framework.
- The amount of R105m for co-generation should also be disallowed to the extent that commercial operation is not going to be achieved during the application year.
- The small scale IPP at R286m or 155c/kWh should also be disallowed as it is outside the DoE IPP programme and at substantively higher cost.
- Total potential saving on IPPs is therefore at least R7842m

Potential Savings in IPP Costs

- The application is silent on the online RE-IPP production capacity and assumed load factors for the application year, it is therefore not possible to assess if the expected production levels (GWh) and price escalations are in accordance with the respective power purchase agreements(PPAs).
- NERSA urged to carefully consider RE-IPP procurement to be in strict compliance with respective PPAs.
- The application includes additional R1962m as part of DOE Peaking IPP operating expenses for 2016/17. It therefore overstates actual expenditure for 2016/17 when compared to the audited AFS of 2016/17 without stating reason
- NERSA must investigate possible alignment of its provision for costing of the DoE peaking plant to be in-line with international accounting practice in order to ensure that the customer does not pay double for this cost item and that Eskom does not as a result make windfall gains by front loading the particular IPP cost.

Potential Savings in IPP Costs

- The MYPD3 decision allowed Eskom R7486m for DoE peaking plant and an additional R2377m as per the current application
- Total project cost for Avon and Dedisa were approximately R9700m subjected to a 15 year PPA with Eskom.
- The annual operating expenditure Eskom seeking to recover via tariffs should therefore be assessed in the context of the requirements of the particular PPAs.

Potential Savings in Primary Energy

- As per the Eskom own calculation, it should have due to the drop in actual sales volume realized savings of at least R10.812m in its own generation cost as they owed to vary with the level of production.
- Eskom was allowed R58404m for own primarily energy generating cost for 2017/18.
- It has applied for R54434m therefore only R3970m lower than what was allowed for the last year of MYPD3,
- However the savings should have been at least R10812m.
- Based on the variance in actual volume of electricity generated and sold Eskom should have realized additional saving of at least **R6842m**, especially when time value of money is not taken into consideration.
- It would therefore be prudent and efficient for NERSA to disallow Eskom the amount of R6842m in own generation primary energy cost to fully compensate for reduction in production volumes.

Potential Savings in total OPEX

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- According to the MYPD3 decision Eskom was allowed approximately R49468m opex for the last year
- Its is now applying for R62221m which is R12753m higher.
- When the amount of R49468m is adjusted by the 7.96% increase Eskom applied for it will at best be R53404m or R8817m lower than the current application.
- It would be prudent to at most limit the Eskom total operating cost allowed for 2018/19 to R53404m.
- Any total operating cost above R53404m should be considered inefficient and therefore be disallowed.
- As long as Eskom's allowed revenue is guaranteed by means of the RCA mechanism it would be prudent to disallow at least R8817m of the operating cost to ensure that Eskom is incentivized to manage its operating cost efficiently and prudently.
- It may amount to double dipping to allow Eskom claw back both the allowed revenue to the extent that it does not achieve it as well as to step-up its opex budget at the end of every MYPD cycle.

Potential Savings in total OPEX

- According to the application Eskom expects the HR cost to increase by 1.1% between 2016/17 and 2017/18, and 0.5% for 2018/19 after it over the past four years on average increased by 8% per year.
- The application however does not specify how Eskom intends to achieve such low growth in human resources cost.
- The only inference that can therefore reasonably be drawn from the application is the fact that the budgeted amount of R28363m Eskom applied for 2018/19 may well be exceeded again by actual expenditure at the end of the financial year, given the current levels of staff cost.
- Eskom will in that case in 2019/20, again expect NERSA to step it up again to higher actuals, as is the case in this application.
- Similarly Eskom expects Other Opex to increase by 0.2% between 2016/17 and 2017/18, and 8.0% for 2018/19 after over the previous four years it increased by 18.5%on average per year,
- The application however does not specify how Eskom intents to achieve such low growth in this cost item in the current year.
- The only inference that can be reasonably drawn from the application is that the amount of R33461m Eskom applied for 2018/19 will be exceeded given the current levels of other opex cost,
- It will go on and on unless NERSA exercises diligence and insist on prudent and efficient use of resources to Eskom.

Potential Savings in Environmental Levy

- The environmental levy currently at 3.50c/kWh is going to amount to at least R7994m, while the round 1-3 RE-IPP cost will amount to R31203m if allowed.
- Since the objective of the levy is to penalize the customer for the use of non-renewable source of primary energy it is tantamount to double taxation to expect the same customer to also pay for the full cost of switching to renewable energy.
- It is therefore proposed that the levy be reduced to 2c/kWh and that the potential savings of R3426m will be achieved.

Tariff Increases - The Vicious Cycle – It's all Interconnected!

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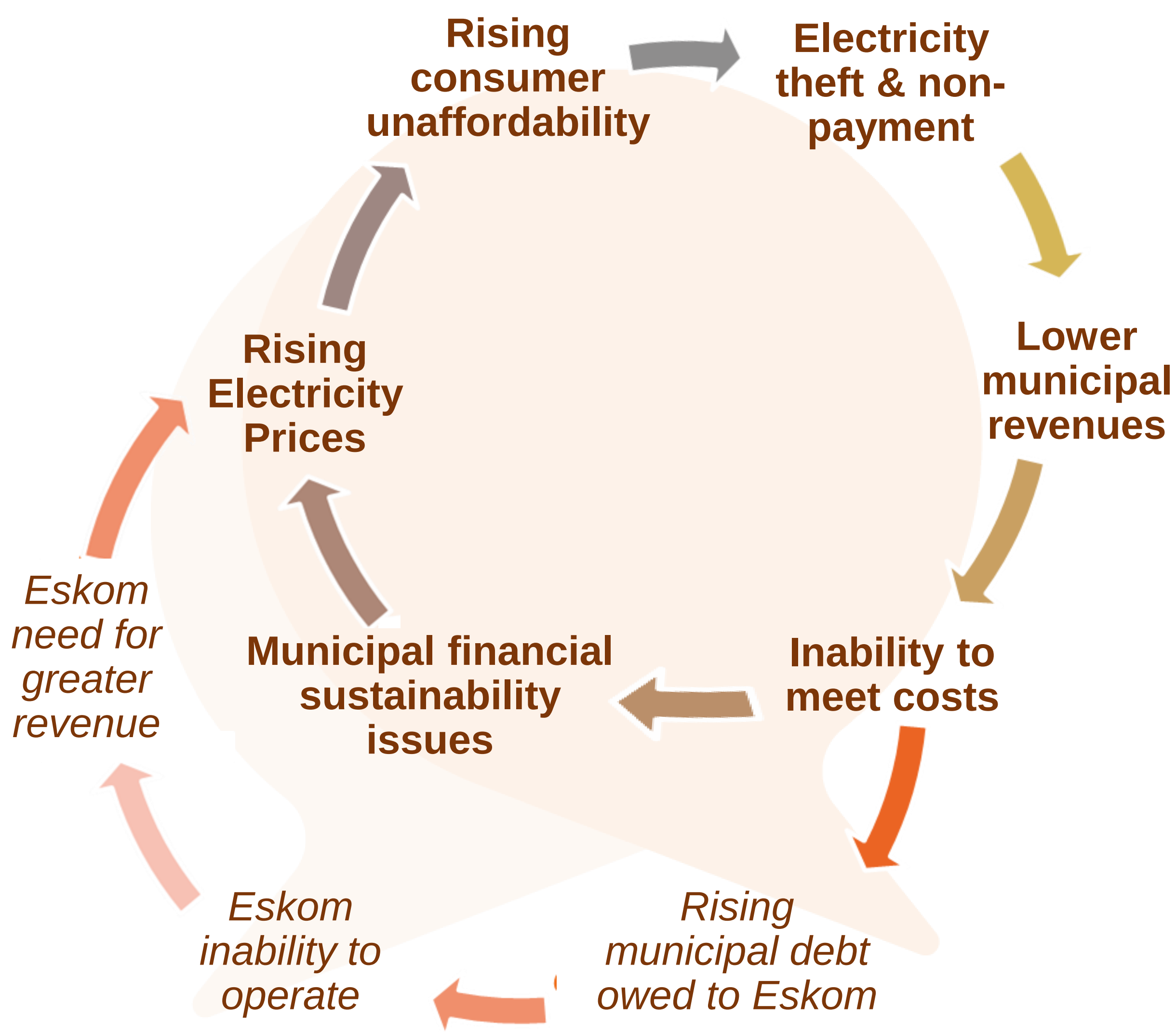

Conclusion

- **SALGA rejects the Eskom Revenue Proposal for 2018/19**
- Its unaffordable and indefensible
- Several potential savings can be drawn from Eskom application, opportunity to protect the customer by NERSA
- Munics and country as a whole cannot take any double digit increase, not now and not in the next few years until economic growth picks up again, until unemployment rate is reduced, until non-payment challenges are addressed etc.
- We all have to tighten our belts and this includes Eskom and Municipalities
- NERSA will be entrusted with the task to make sure that inefficiencies are not incentivized at the cost of the customer and country as a whole

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