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SALGA Response to Eskom MYPD4 Application & Regulatory Clearing Account for year 5 of MYPD3

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Introduction

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- The ESI is experiencing a delinking between economic growth and electricity demand growth.
- Electricity sales show a sustained downward trend over the last years and have dropped significantly.
- Today the sale of electricity is at record low levels for all municipalities, Eskom, the debts to municipalities and theft rising at an exponential rate.
- Peak consumption levels are however not following the same trend, driven by high households' electricity consumption, particularly in the evening peak.
- These intertwined dynamics have major implications for municipalities that are compelled to re-define their role in the electricity value chain and adapt
- The model of bulk purchases from Eskom and selling kilowatt hours to customers is no longer a profitable and sustainable model for local government, especially within the current economic landscape.
- It is for this reason that SALGA supports municipalities like City of Cape Town, Ekurhuleni, eThekwini etc. who are exploring other sources of energy from other players including for their own use

The Eskom Application/s

- Eskom's third Multi-Year Price Determination (MYPD3) Regulatory Clearing Account (RCA) Year 5 (2017/18) application totalling R21 624m

- Fourth Multi-Year Price Determination (MYPD4) application totalling R219bn, R252bn and R291bn for the 2019/20, 2020/21 and 2021/22 financial years respectively

Recent Decisions

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- On 14 June 2018, the Energy Regulator approved a total RCA balance of R32.69 billion for the three years as follows:
  - an RCA balance of R12.577 billion for the 2014/15 financial year;
  - an RCA balance of R12.058 billion for the 2015/16 financial year; and
  - an RCA balance of R8.055 billion for the 2016/17 financial year.
- On 2 October 2018, NERSA issued a statement on the liquidation of the above RCA balances.
  - Eskom will recover R7 776m from Standard tariff customers from the 2019/20 financial year until the 2022/23 financial year. Everything else remain the same.

Summary of the RCA Application

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RCA for 2017/18 (Year 5 of MYPD3)	MYPD3 Decision	Actuals 2017/18	Variance to MYPD3	RCA adjustments	RCA 2017/18
Total Revenue R million	**205 213**	**175 041**	**30 172**	**-3 277**	**26 895**
Primary Energy , R million					
Coal	49 914	46 992	-2 922	-15	-2 937
Open Cycle Gas Turbines (OCGTs)	1 724	328	-1 396		-1 396
Other primary energy	6 766	7 576	810	-	810
Independent Power Producers	23 018	19 317	-3 701	1 983	-1 718
International Purchases	470	2 768	2 298		2 298
Environmental levy	9 746	8 061	-1 685		-1 685
Demand Market Participation (DMP)	-	160	160		160
Total primary energy , R million	**91 638**	**85 202**	**-6 436**	**1 968**	**-4 468**
CECA for RCA , R million	**33 667**	**34 592**	**925**	**0**	**925**
EEDSM for RCA , R million	**1 244**	**142**	**-1 102**	**-17**	**-1 118**
Operating costs for RCA , R million	**47 764**	**51 892**	**4 128**	**-4 128**	**-**
SQI for RCA , R million				**390**	**390**
Inflation adjustments , R million				**39**	**39**
ECS (Electricity conservation scheme) adjustment				**-1 122**	**-1 122**
FY2018 RCA application for year					**21 541**
Nuclear decommissioning from RCA 2013/14 decision phased in over 10 years for liquidation					**83**
FY2018 Liquidation claim , R million					**21 624**

SALGA Response to RCA

- The application is dominated by the shortfall in sales (over R26bn)
- Too much burden hanging over SA customers with the recent RCAs that will be liquidated parallel to MYPD4
- The concept of the RCA framework is understood and appreciated but in this RCA customers are purely just asked to pay higher tariffs just because Eskom didn't sell enough electricity and could not minimize costs of sales to align to what it achieved. Not fair
- We cannot keep punishing customers for lower demand and less purchases that are inevitable and not their fault.
- Understood that electricity is a fixed cost intensive business but it does mean there cant be any austerity measures to minimize costs
- Municipalities are also selling less, most if not all are having negative growth, high electricity theft and non payment levels
- NERSA must make a decision that is not to the detriment of the customer.
- This RCA is not supported.

Response to MYPD4 Application

Consultation

- SALGA Received Eskom letter which is dated 27 July 2018 with its MYPD4 application
- In terms of section 42 of the MFMA, SALGA and its members are requested to provide written comments on the proposed application within a period of 40 days
- SALGA went through its own internal consultation process with its members to comment and make a decision on the local government position
- SALGA hosted Eskom and municipalities on 05 September 2018 for a workshop discussing in details the Eskom application and for Eskom to respond to any matters of concern from SALGA and municipalities
- The purpose consultation is not for parties to agree but to clarify any matters arising and agree to disagree in some cases
- Further to this workshop SALGA sent out a document with further questions and issues of clarity. No response to those issues as yet.

Customer Centricity

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- The Revenue Application document states Customer-centricity. When the tariff is increased by 15% per annum for 3 consecutive years, it is clear that Eskom is out of touch with reality and this is not a customer-centric approach.
- These levels of tariff hikes are making it more affordable for more affluent customers to go off-grid.
- The most vulnerable, the working class and the unemployed poor people of South Africa, don’t have much options
- This either results in non-payment as the opportunity to cross-subsidise the more vulnerable in the community is being eroded.
- Other previous users of electricity opt for the use of more dangerous forms of energy, such as paraffin, which has destroyed many townships and devastated many lives in recent fires.
- Commercial customers will also continue their investment in their own energy sources independent of municipal and Eskom supply,
- This will further negatively affect Municipalities and Eskom’s sales volumes.

Customer Centricity (2)

- Eskom refers to major structural shifts in the country which would affect their sales volumes, but don’t appear to make provision for this its financial models.
- The document explicitly mentions initiatives to grow sales volumes from customers.
  - These customers include industries and mines, many of whom are in distress, including municipalities, which are also financial sustainability challenges, due to rising unemployment and limited economic growth.

Sales Volumes/Growth projections

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- In a previous 2018/19 revenue application Eskom clearly showed how the sales volume rebasing was required.
- This is when actual volumes were on a decline since 2012 and Eskom projections were still indicating a positive growth.
- Municipalities are all experiencing negative growth and this number is at least 2%, it represents just over 40% of Eskom's sales volumes and should leave a big enough motivation to project negative growth of sales by Eskom.
- If these prices are to be approved by NERSA with the RCA on top of that, elasticity must also be taken into account, otherwise it has to be argued that Eskom has lost the plot.

Electricity Sales/ revenue in municipalities

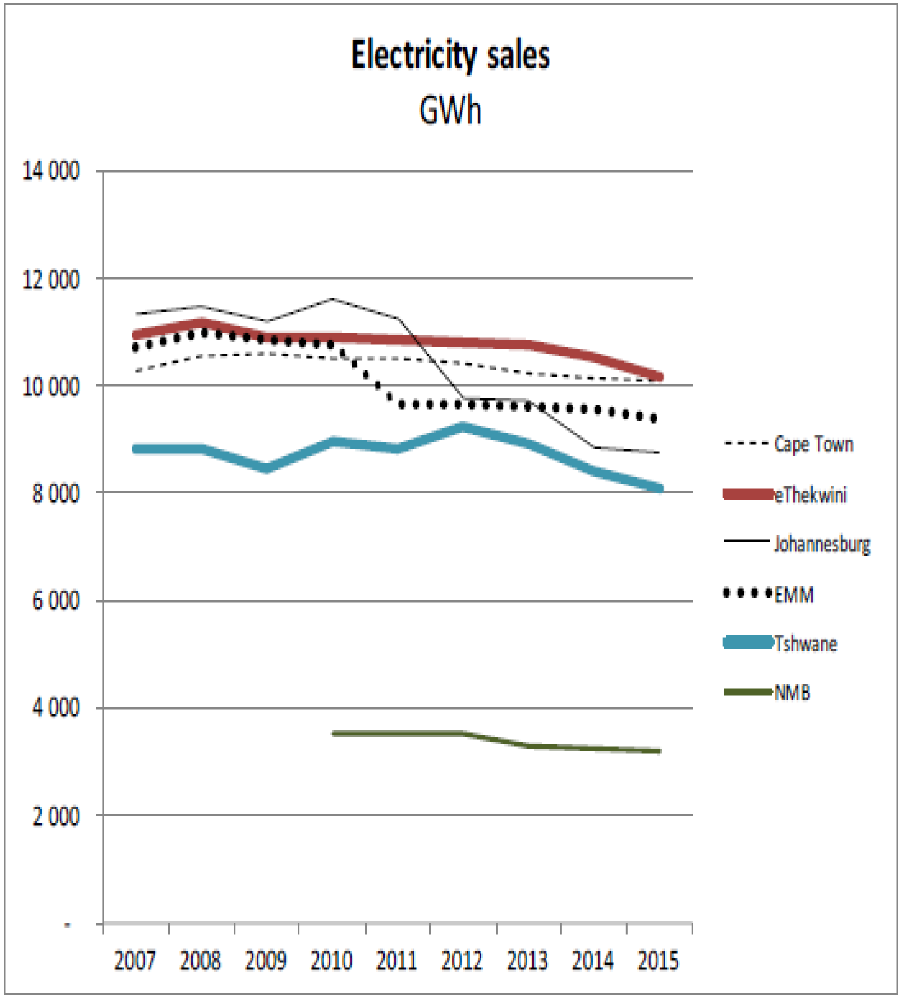
- *"The centrality of electricity revenue and expenditure within a municipality's finances is unquestionable.*
- *<u>Revenue earned from electricity goes a long way towards enabling municipalities to meet their developmental role as envisaged in the Constitution</u>.*

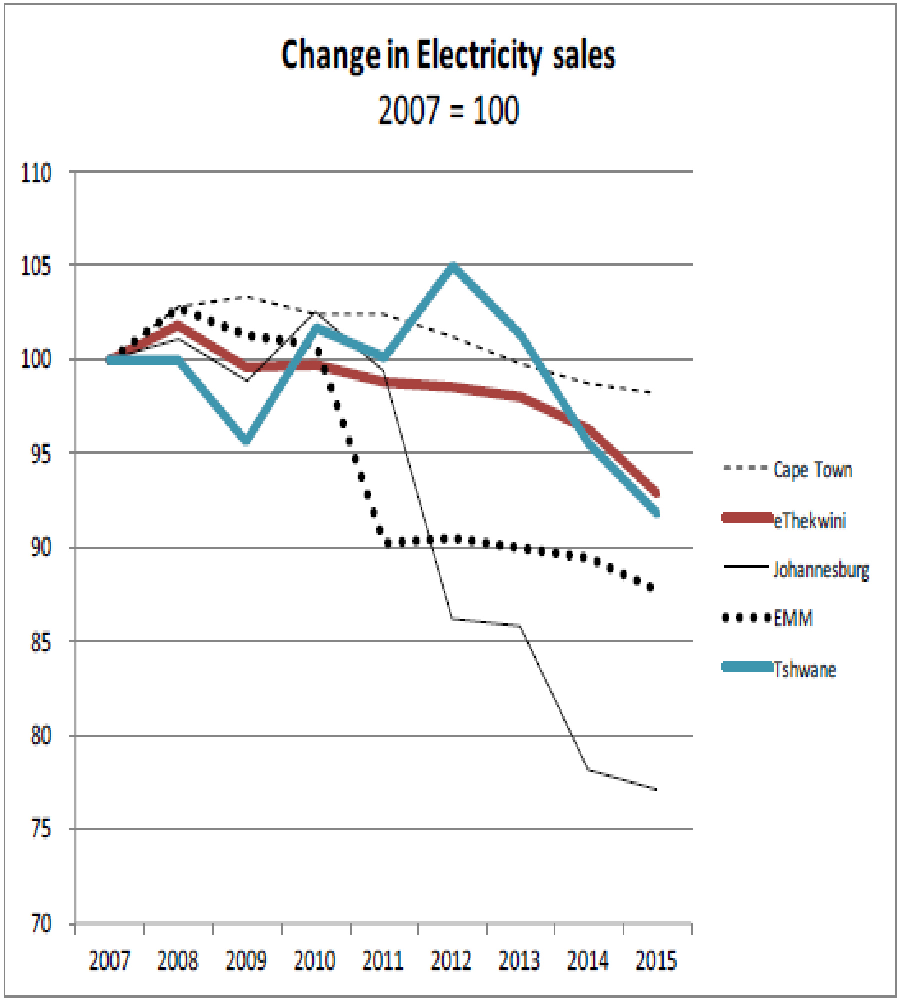
"However,

- *the pressure of increasing electricity costs places at risk the very sustainability of a municipality.* ***All local government, except metros, have moved from a surplus in electricity sales to a loss****, and metro surpluses are under threat". (FFC**, 2016:274).*

Financial and Fiscal Commission (FFC). 2015. CHAPTER 10 - The Impact of Electricity Price Increases on Municipalities Technical Report: Submission for the Division of Revenue 2015/2016 For an Equitable Sharing of National Revenue. 30 May 2014.

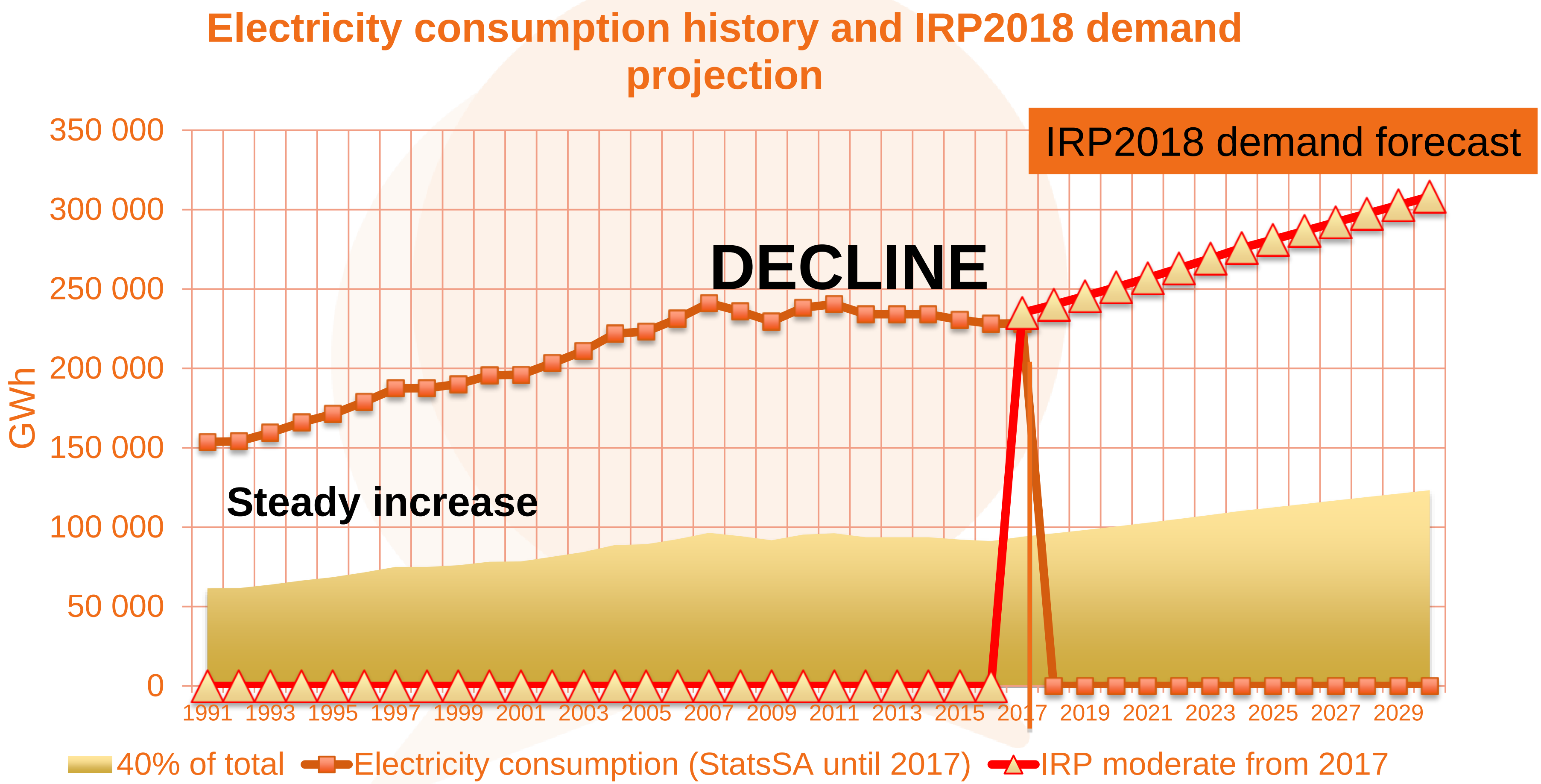
Electricity Sales/ revenue in municipalities





DEMAND FORECASTS

- **IRP 2018**



DEMAND FORECASTS

Since 2007, the electricity supplied from grid (Eskom) to municipalities has not been increasing (flat at best)

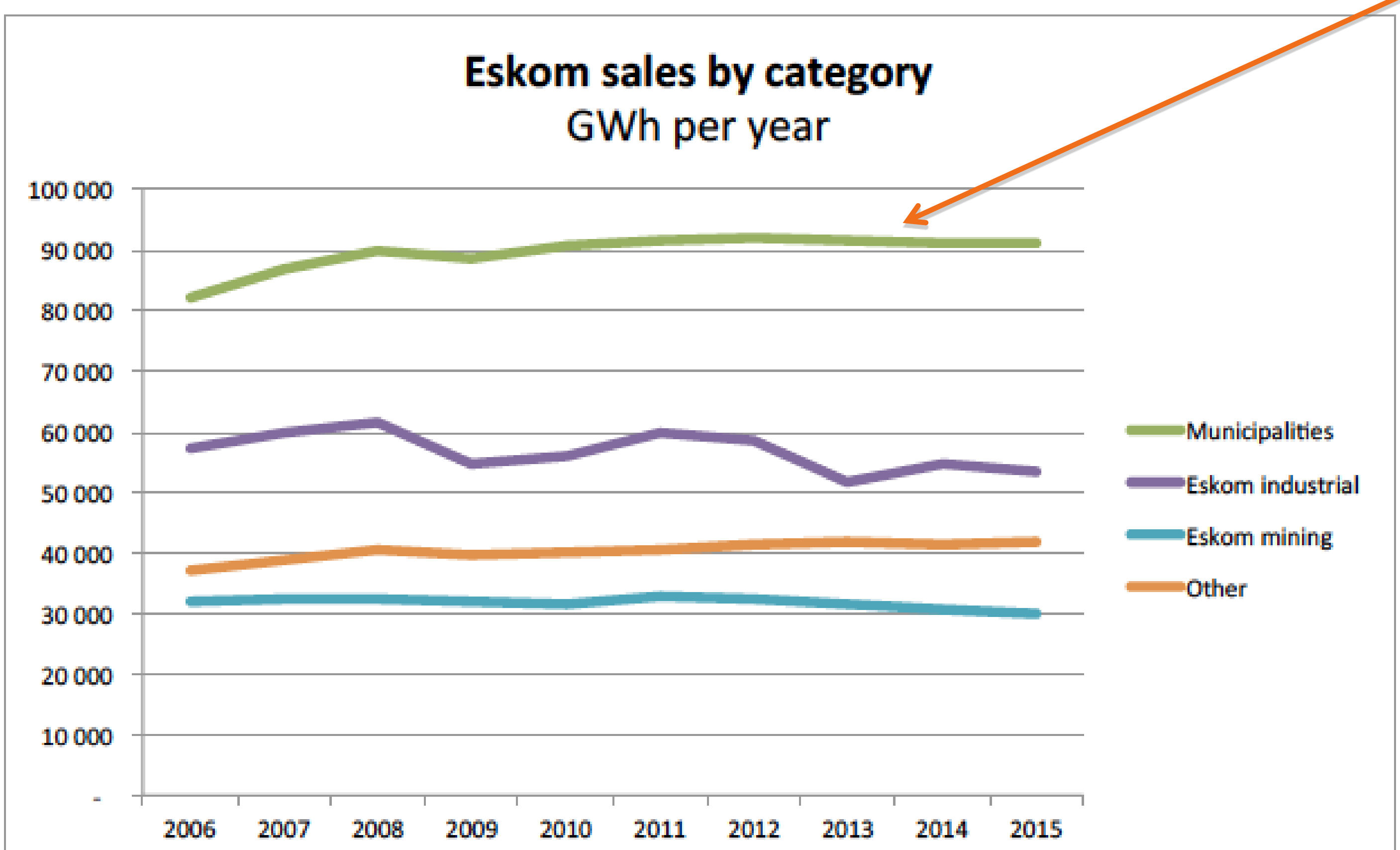
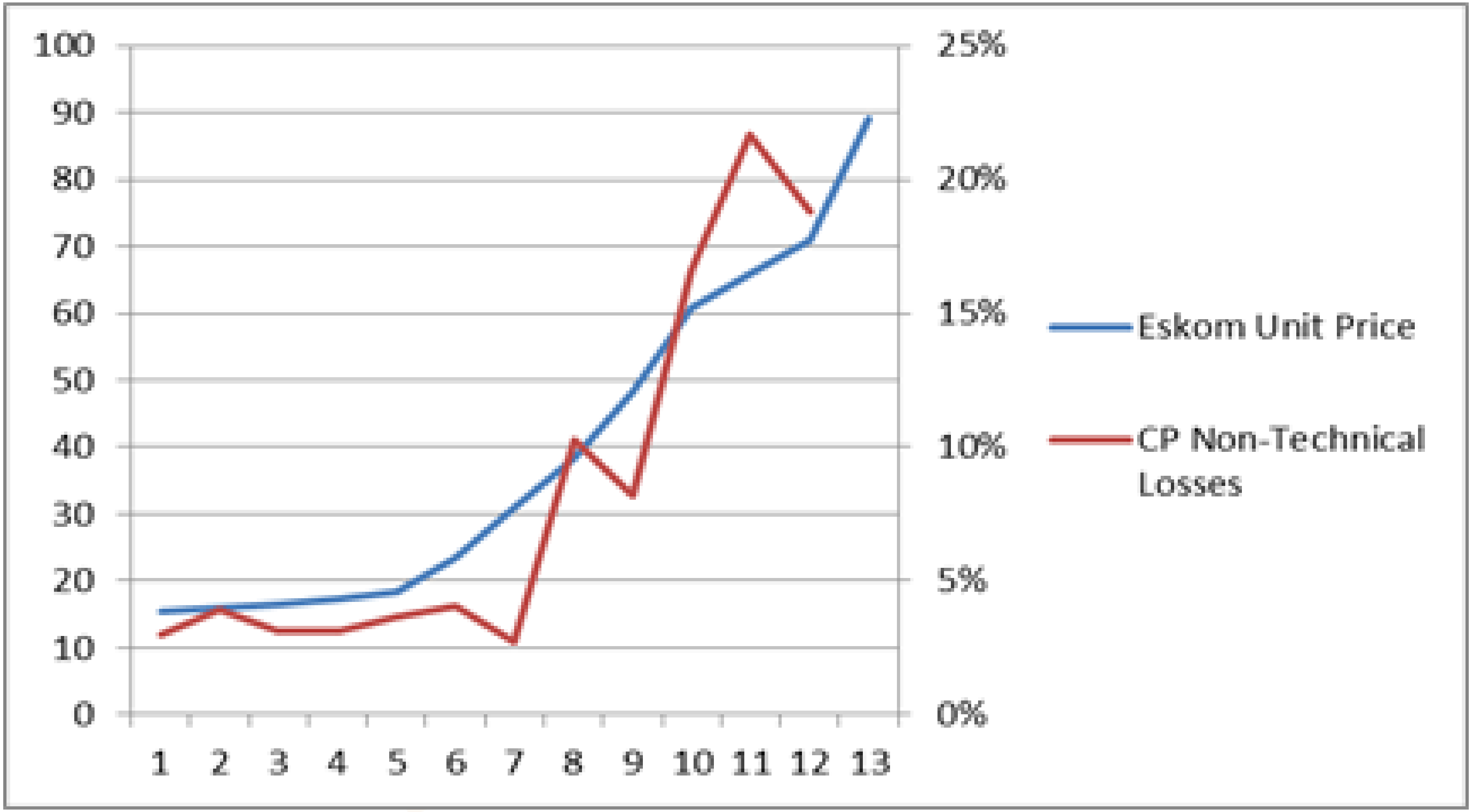


Figure 8: Eskom's sales by main customer category

Price Sensitivity Issues (1)

- Strong statistical correlation between the two non-technical losses over the last 10 years in relation to the Eskom price increases,
- This is not to say that the Eskom increases alone were responsible for the increases in the non-Technical losses
- While customers may be inclined to bypass municipal metering in accessing electricity as prices go up there is nothing that prevents utilities to put measures in place to counter increased energy losses.
- These higher prices are not going to assist Eskom achieve financial sustainability, since the municipalities are also struggling to cover the rise in cost of doing the business
- The local or municipal socio economic and tariff policies are restricting municipalities to increase their electricity tariffs to the end user to cover the cost of supply
- NERSA limiting increases also to munics where there are high non technical losses,
- Many will get to a point where they default on Eskom payments.

Price Sensitivity Issues (1)



Price Sensitivity Issues(3)

- Mechanisms need to be introduced to curb losses throughout the system – and to limit the continual increases way above inflation or cost of living levels.
- As price levels increase, it follows that small business profits are eaten away by the unforeseen increases that just cannot be absorbed.
- These small businesses fold, leaving an even greater impact on the larger community as more become unemployed. [A case study on SMMEs in Cape Town a couple of years ago worked out that each employee in an SMME was impacting up to 6 others with their earnings.
- Thus, as these small companies go out of business 6 people are affected for each employee that loses their job. [The assessment was done by the Cape Town Partnership.]

Price Increases of 45% over 3 years

- The South African Reserve Bank forecasts average inflation of 5% in 2019, 5.3% for 2020 and 4,8% for 2021
- It goes without saying that non-technical loses will be expected to skyrocket accompanied by more payment defaults
- Further reduction in sales volumes because of the price elasticity of demand, which was previously thought to be insignificant, but is seen today as a strong influence.
- Not only will the price increases cause a bigger investment in Energy Efficiency Measures, but will also really strengthen the business case for alternatives
- Eskom is depending entirely on the inelasticity price of electricity, but as more substitutes become available consumers are shifting towards alternatives
- The rich moving over to new technology as they can afford the substantial investment required in order to achieve stability in supply and some certainty on the cost structure of electricity

Can Munics tolerate & absorb any further price increases likely to be implemented by Eskom for 2019 and beyond? (1)

- Energy used in buildings, housing, municipal functions, Street lighting services, fresh and waste water pumping all consume energy and the cost of providing these services increases with every Eskom increase.
- These costs are ultimately passed on to the end consumer. We have to absorb these additional costs and it affects the bottom line.
- It must also be remembered that in terms of the EPP, municipalities have an obligation to protect the poor by creating cross-subsidies from commercial and industrial customers.
- The poor residential sector is a significant contributor to the morning and evening peak periods, so munics must create subsidies for the most expensive energy in order to meet the EPP objectives.
- The biggest actual price increases are seen on the peak energy prices, unless Eskom changes the ratio of peak to off-peak prices, this problem really affects the municipal bottom line, and badly

Can Munics tolerate & absorb any further price increases likely to be implemented by Eskom for 2019 and beyond?(2)

- Households are already over-indebted and burdened with ever increasing commodities.
- Munics like City of Cape Town, in an attempt to absorb price increases from Eskom and retain a sustainable and certain income stream, has introduced a R150 fixed basic electricity charge for properties valued at over R1 million.
- This cost is an attempt to at least maintain infrastructure standards by ensuring a revenue stream to cover the costs of repairs and maintenance.
- The limitation on residential properties with a valuation of over R 1 million is an attempt to only pass the cost onto those that can afford it and protecting the poor vulnerable from further price increases.
- With the increase in property values this means that even areas where consumers enjoyed some protection against price increases will now need to pay extra for electricity.

Can Munics tolerate & absorb any further price increases likely to be implemented by Eskom for 2019 and beyond? (3)

- Municipalities can no longer absorb costs, maintain staff to address the servicing of infrastructure involved in the delivery of electricity services,
- Also must also adhere to national standards of extending electricity services to those who, as yet, have not had the experience of electricity being provided to their dwelling.
- This initiative needs to continue, but the cost of the basic infrastructure and first free units to residential units, without any return on these investments, means that the full burden of increases has to be passed on to the ever shrinking pool of end users due to the adoption of alternate power sources – even if just for part of the daily power needs.

What is the Optimal Price that Municipalities can tolerate? Can we have a direct answer to this?

- Municipalities are in the uncomfortable position that they have to mark-up sales to create funds for they own network maintenance as well as generate a surplus for the municipality.
- This means that their energy costs are not competitive with those of Eskom, and what we see is a migration of industry out of municipal areas
- Municipalities cannot reduce for one tariff group only and become short of pocket if we are forced to reduce prices on an individual basis (like in the case of the Ekurhuleni court case.)
- Perhaps we need to do an analysis of how many businesses have moved out of municipal supply areas or who have simply closed shop. These figures are most telling….
- Requests from the foundry industries for reduced prices is not possible in munics within this is a regulatory regime, a discount for one class of customer will inevitably result in a price increase for another.

What is going to happen? Or Maybe already happening

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- Municipalities signing up with IPPs to supply electricity e.g. Nelson Mandela Bay Municipality and Power X, an IPP.
- More and more munics want to sign up with IPPs or develop RE plants for their own consumption
- Small industry and Commercial buildings looking for more alternatives and Energy Efficiency interventions. The greater the increase, the more pronounced the interventions will be.
- Most municipal residents are already using less power and this is affecting the demand hence the need for the municipality to introduce fixed cost to cover maintenance of infrastructure.
- Eskom could see less demand in the foreseeable future. What will their solution be to this? Increase prices?

Cost Containment and Increasing Debt Cost (1)

- Gearing of around 72%
  - The problem may not so much be the gearing, but the cost overruns that have caused the excessive and increasing debt.
  - Apparently a lot of the penalties that Eskom should have applied (R40 Bn reported) on construction and equipment suppliers were not, and perhaps this is something that can be pursued.
- Eskom recently asked for a bookkeeping entry of R100 billion of government debt to be reclassified as equity in order to lower its debt to equity ratio, but then at the same time to borrow a further R100 billion rand.
- We see this as no commitment from the entity to lowering its debt to equity ratio.
- Any further debt incurred will put the south African economy at huge risk.
- Instead of shifting values around through journal entries, Eskom needs constructive and sustainable mechanisms to reduce debt.

Cost Containment and Increasing Debt Cost (2)

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- The concept of Eskom being in a financial death spiral is acknowledged
- It would be far more beneficial for Eskom to substantiate the real costs of efficient and effective service delivery against the proposed price increases.
- Eskom has brought little to the table to show the cost containment measures it has implemented in order to minimise costs, especially in the RCA
- The World Bank review of the staff complement benchmarked against world standards creates the expectation that the reduction in costs will be clearly articulated against the adjustments to staffing levels over time.
- Consideration should be given to new conditions of service that remove some of the old benefits that escalate costs without any value add
- A strong stance should be taken to introduce major austerity measures throughout Eskom that will significantly contribute to reducing overheads over the longer term

Conclusion

- SALGA and municipalities submits that in the current economic climate, the Eskom's proposed tariff is unaffordable and beyond cost of living adjustments.
- It is highly unlikely that customers will be able to afford three years of compounded increases of a minimum of 15% per annum, plus multiple RCA increases parallel to this
- It is accepted that the revenue application is a separate process from the RCA but they will still greatly impact on these proposed increases.
- There is a need for NERSA to consider "performance-based regulation" for Eskom. Set performance targets in several aspects of Eskom operations,
- Appreciates and sympathize with Eskom's financial challenges but everyone is going through this, there are no holy cows.
- Confidence in NERSA to make the right decision as outlined in the ERA, which amongst others are:
  - Affordability
  - Universal Access; and
  - Allow **efficient** utility to recover its costs with reasonable margins etc.

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Thank you

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