SOUTH AFRICAN LOCAL GOVERNMENT ASSOCIATION

SALGA

Inspiring service delivery

SALGA Position on Eskom Revenue Proposal 2018/19

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16 November 2017

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Introduction

Cllr Matshidiso Mfikoe

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.

At glance	
Eskom claims that the 2.2% average increase in the 2017/18 resulted in the consumers receiving a decrease in electricity prices	SALGA and municipalities do not agree
Eskom claims a situation where costs to produce its electricity have been increasing and reporting that sales volumes have dropped	Not reason enough to make the customer pay for lower sales experienced by Eskom
Primary energy costs has increased due to a combination of coal mix changes, use of more IPPs and operating costs growth	SALGA and municipalities don’t agree, the IPP, primary energy is mostly from renewable energy, Eskom own primary energy must reduce with the sales reduction

SALGA Position

- **SALGA rejects the 27.29% increase**
- The 27.29% price shock effect on the market is unaffordable and indefensible – **6 times the inflation**
- NERSA MUST NOT , allow inefficient costs to be passed on to the consumer
- Eskom must stop forecasting higher sales revenue when the reality state otherwise and want to municipalities and customers to pay for it
- Long term pricing approach must be adopted where prices are gradually increased or amended, allowing for the market and role-players to adjust accordingly.
- There are several possible savings for the Eskom revenue proposal
- More price increase perpetuate the non-payment and theft culture in an economy with over 30% unemployment and less than 2% growth

Summary of Observations

Nhlanhla Ngidi

Lets go back to MYPD3 Decisions

- 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**

MYPD3 Actual Increase	2014	2015	2016	2017	2018
STC GWh	206,412	208,442	213,545	218,194	223,219
STC Allowed R'm	135,226	147,481	163,179	180,070	198,954
STC RCA			7,085	10,257	
STC Allowed R'm & RCA			170,264	190,327	198,954
STC c/kWh	65.51	70.75	79.73	87.23	89.13
Percentage Increase %	8.00%	8.00%	12.69%	9.4%	2.2%

Summary of Observations

- 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

- 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
- 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?

Detailed Analysis from the SALGA Members

Lonwabo Magida

(City Power)

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Eskom 18/19 Revenue Application
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City Power Presentation
Lonwabo Magida
16 November 2017

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1 Background on City Power Operations

City Power at a Glance… June 2016

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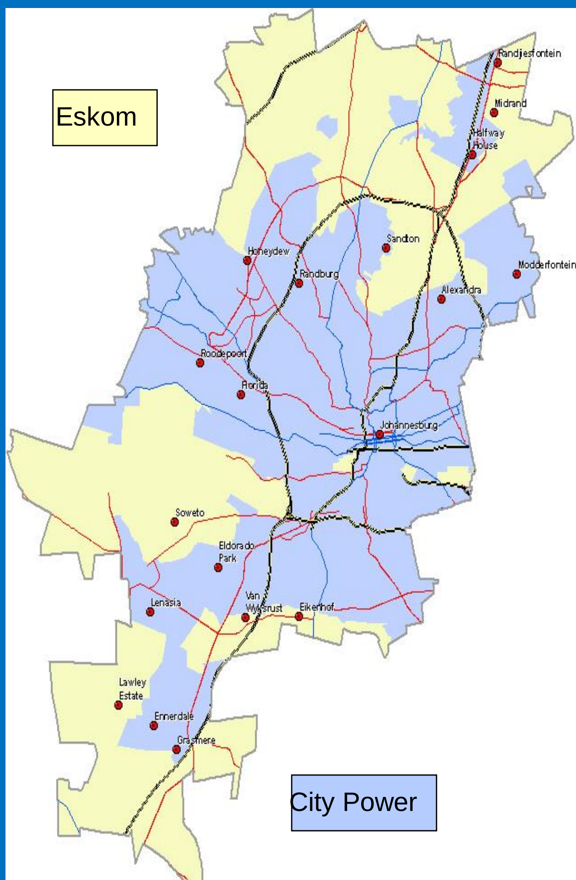

MOE: City of Johannesburg is the single shareholder of City Power

Number of customers: Over **390,000** - LPU: **1%**, Prepaid: **62%,** Conventional Business/Domestic: **37%**

Infrastructure: over **17 500km** of cable, over **18 000** substations, and over **270 000** public lights ,

Estimated asset value : **R52bn**

Revenue: over **R14bn**

Employees: over 1,700

Current peak demand is over **2800MW** which is **8-10%** of national load

Capital investment: over **R11,8bn** invested in infrastructure in the past 10 years

ISO: Only utility in Africa with **four ISO accreditations** (9001, 14001, 18001 & 31000)

ISO 26000 **compliant** and currently implementing 16000

Head Office: National Key Point

Background

2 Effective 17/18 Tariff increase and Sales volume Rebasing

Effective Eskom Tariff increase over MYPD3

MYPD3 Allowed Increase	2014	2015	2016	2017	2018
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STC Allowed R'm	135,226	147,481	163,179	180,070	198,954
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Percentage Increase %	8.00%	8.00%	8.00%	8.00%	8.00%

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- Eskom's FY17/18 average selling price & allowed revenue are at the levels envisaged by original MYPD3 Decision,
- The allowed revenue in FY1617 was R190b and no longer R180b due to RCA implementation, and only required a 2.2% average increase in tariffs to get allowed revenue of R198b,
- Therefore, the customer did not receive an effective decrease in tariff.

Total sales forecasting vs variance in level of sales (GWh)

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MYPD	2012	2013	2014	2015	2016	2017	2018	6 year Average
Forecast Sales GWh	233,400	237,932	227,404	229,513	235,638	239,113	244,026	
Forecasted Growth Rate %	2.25%	1.94%	-4.42%	0.93%	2.67%	1.47%	2.05%	0.81%
Actual Sales GWh	224,785	216,561	217,903	216,274	214,467	214,121	213,981	
Actual Sales Growth Rate %	0.15%	-3.66%	0.62%	-0.75%	-0.84%	-0.16%	-0.07%	-0.77%
Variance in GWh	(8,615)	(21,371)	(9,501)	(13,239)	(21,171)	(24,992)	(30,045)	
Variance in %	-3.69%	-8.98%	-4.18%	-5.77%	-8.98%	-10.45%	-12.31%	

- Sales Growth rate forecasting variance very minimal over longer term horizon,
- Whereas the likely sales volume variance by 2018 at 12.31% is significant,
- Unless rebased Revenue variance/RCA is guaranteed irrespective of actual NERSA decision,
- Effective and prudent cost management should be responsive to consistently lower levels of actual production & sales

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2 DOE Peaking IPP, RE-IPP & Eskom PE

DoE Peaking IPP

- According to the financiers the DoE Peaking plant cost approximately R9.7b and Eskom has a 15 year Take/Pay PPA *(Absa public source)*
- Eskom applied for R13 340m, was allowed Eskom R7 486m over MYPD3 and now applied for additional R2 377m, total of R9 863m over only 6yrs,
- Construction started in 2014 while full commercial operation was achieved only between 2015-2016,
- Eskom production plan reduced generation by peaking plant from 440GWh/a (MYPD3) to 88GWh/a though it has a take or pay PPA that must guarantee a minimum payment / a specific minimum load factor. Therefore, there may be optimization issues from these PPAs
- Eskom in its application claims R1 962m as part of primary energy cost though the AFS16/17 does not include any amount as part of primary energy cost, however some amount may have been capitalized therefore included in depreciation, finance cost, etc. otherwise the application is silent on reconciliation
- NERSA should study the potentially different accounting treatment as well as the amounts involved to ensure full alignment of allowed cost to the signed PPAs.

RE-IPP

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- Limited information provided in application with respect to Renewable IPP programme for example the following:
  - Production Capacity,
  - Production factor,
  - Price escalation clauses,
  - Treatment of internal Eskom RE-IPP administrative cost

- NERSA urged to carefully consider RE-IPP procurement in strict compliance with respective PPAs,

- Eskom internal administrative cost should not be included as part RE-IPP procurement cost in order to avoid any double count, e.g. Human Resources involved in RE-IPP administration may be included in Eskom overall staff count as well as part of RE-IPP procurement cost.

- Rounds 3.5 – 4.5 may not have reached financial closure as yet and should only be included in allowed cost beyond the 18/19 tariff window, due to the fact that it takes 18-12 months from financial closure to achieve commercial operation. This will minimize the potential timing differences between revenue collection and procurement from such RE-IPPs.

Eskom Primary Energy

- According to p31 of 163 of Eskom Revenue Application for FY18/19, “lower sales volume will result in own primary energy cost savings of R10.8b”

- However saving in production cost due to favorable volume variance not fully incorporated into own PE costing on p67 of 163. There is scope for further savings of R6.8b or R5.3b depending on if the environmental levy is included in the calculation.

- Other PE cost considerations where savings can potentially manifest themselves;
  - Clarification of Coal obligation provision of R1.3b
  - Escalation in Water Use cost of 25% in base year while only 6% in application year,
  - Escalation in fuel and water procurement cost of 30% in base year while only 6% in application year,
  - OCGT usage can be limited to levels achieved in 2016/17 financial year of 29GWh,
  - System average auxiliary at 8% unusually high (p87 of 163),
  - Production Plan to be re-assessed by NERSA if changes are made.

Operating Expenses

3 Potential Saving in OPEX

Operating Expenditure

- According to p89 of 163 of Eskom applied for total opex of R62.2b, yet it was allowed only approximately R49.5b for FY17/18 (base year), when adjusted for 7.96% (other opex rate of increase) it can at best be R53.4b in application year

- Application therefore approximately R8.8b above MYPD3 approved prudent and efficient total opex

- Eskom should be held to what was considered to be prudent and efficient opex cost at the time of the MYPD3 decision, in line with the current MYPD Methodology which also provides for pending processing of MYPD3 RCA applications

- Allowing Eskom additional opex may be tantamount to transferring all risk associated with prudent and efficient management entirely to the customer, as Eskom can simply after the fact apply for absorption of consistently higher actual cost into the base though such cost may otherwise be controllable.

Environmental Levy

5 Environmental Levy vs increasing RE-IPP cost

Environmental Levy

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- Environmental Levy at 3.5c/kWh (R8.1B) was instituted to encourage use of renewable primary energy source

- Use of renewable energy has since increased to R15.6b and is likely to almost double to R31.2b by the time Round 3.5-4.5 are implemented yet the environmental levy is not reducing though it is achieving its stated social objectives,

- Therefore unless the levy is reduced it amounts to double taxation to end users. Reducing the levy to for example 2c/kWh can result in R3.4b savings to the consumer.

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4 Total Potential Savings

Total Potential Savings

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

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