SALGA Position on Eskom Revenue Proposal 2018/19

Durban

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Background

- 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

- ~~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

- **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.
- 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
- Some elements of the application must be relooked since it's a one year application e.g. Depreciation

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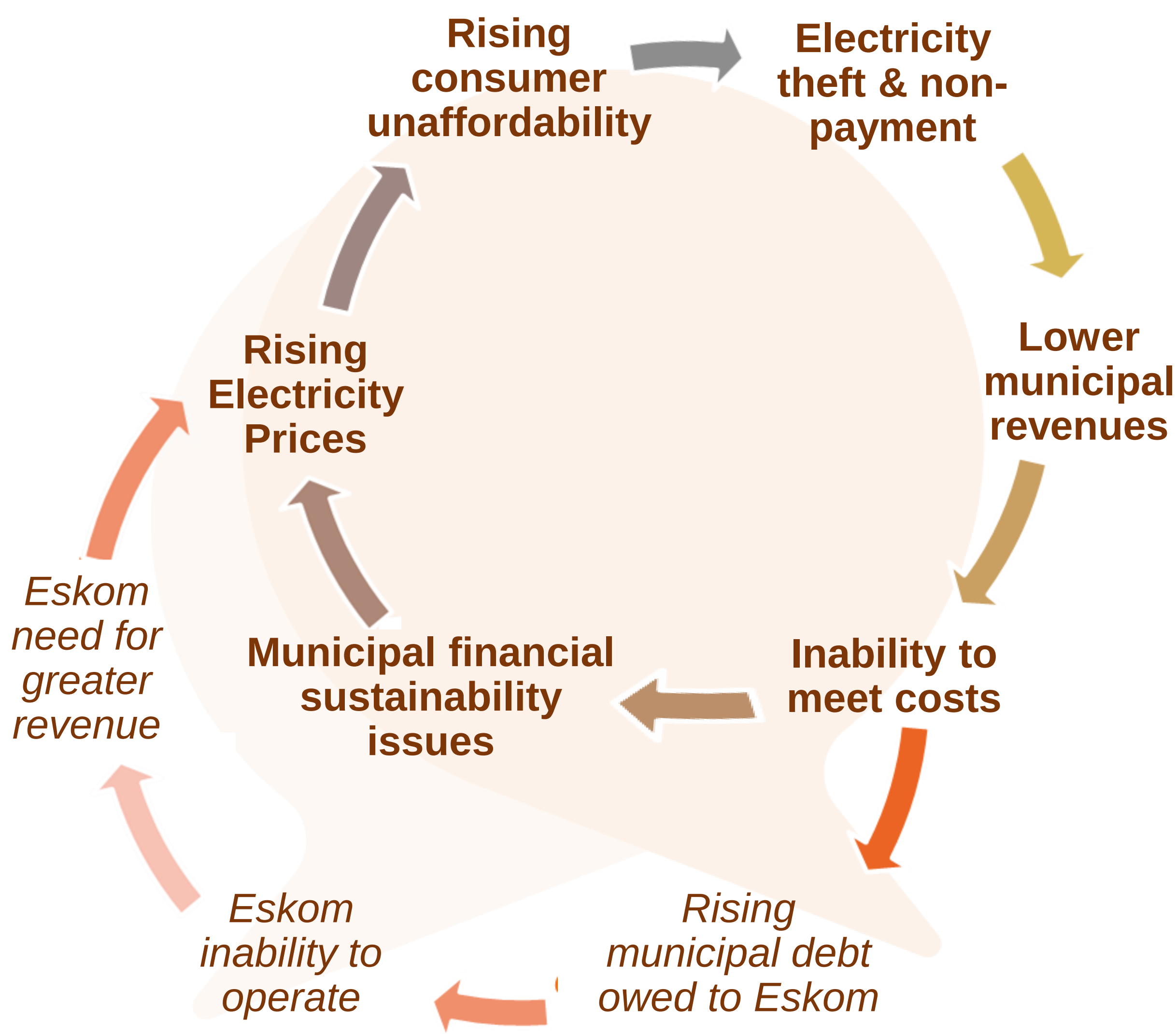
- The summary of the table below shows possible savings of just over R26bn from the Eskom application if considered by NERSA.
- Next few slides to illustrate possible savings

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 Eskom Application

- No new PPA signed since September 2016, unlikely for Round 3.5-4.5 to achieve CO during the application year. NERSA should disallow Potential saving (R7842m), more savings on peaking plant projects
- Eskom savings of at least R10.812m in its own generation cost and have applied for primary energy cost R3970m lower than previous MYPD, variance is R6842m
- It would 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.
- 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.
- Expecting the customer to pay the levy and also to switch to renewables is tantamount to double taxation to expect the same customer to also pay for the full cost of switching to renewable energy.
- If the levy could be reduced to 2c/kWh, there are savings of R3426m
- 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.

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



Conclusion

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- **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

Underway at SALGA

- SALGA Commissioning studies on:
  - Impact assessment of MYPD3 Decisions on Municipalities and the country
  - Impact assessment of Eskom 2018/19 Revenue Proposal
  - Studies on new business models for a modern utility
- SALGA Energy Summit (Feb/March 2018)
  - "Defining Local Government Future Energy Landscape"

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