MYPD 3

Re-opener for selective items (2015/16~2017/18)

o **OCGTs and** o

STPPP

Including the impact of environmental levy changes

30 April 2015

Publishable Version

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1. Context

Eskom is facing several operational and financial challenges which make the task of meeting electricity demands more difficult resulting in the recent load shedding events and regular emergencies being declared. The challenges have become much tougher with rotational load shedding occurring since November 2014 on a more frequent basis. In order to reduce the level of interruptions with the huge consequential impact on the economy, Eskom would need to address the situation and reduce the unplanned outages of the Generation fleet, utilize all possible supply options which are available (incl OCGTs) , commission new build capacity, introduce more short term supply and demand response strategies to stabilize the electricity system. During the last few months several developments have occurred as follows:

- Government has committed to an equity injection in region of R20bn (yet to flow to Eskom). Government has informed Eskom that this equity injection will be made available to Eskom in two tranches. The first amount of R10bn will be made available to Eskom during June 2015 and the second R10bn during December 2015. The additional R3bn will only be considered at a later stage. Government has also clarified that the environmental levy paid by all non-renewable generators (including Eskom generators) is not available for further allocation to Eskom. The National Treasury does not allocate revenue in a ring-fenced manner from its revenue account. The Government has clarified to Eskom that further equity injections to Eskom are not possible in the short to medium term. Thus the possibility of exploring a further equity option has been completely ruled out.

- Ratings agencies have downgraded Eskom which will place pressures on raising debt. Eskom has explored further debt options. From recent experiences in raising further debt, it is confirmed that the limits to further significant borrowings are being reached. Even though an appetite exists for further borrowing, the rates of interest payments are becoming increasingly higher.

- Eskom has launched its internal savings initiative referred to as Business Productivity Programme (BPP) with targeting savings of between R50bn~R60bn over the five year period.
- Eskom has reprioritised its capital portfolio from R337bn to R300bn (of which R251bn can be funded through existing sources) which resulted in reduced allocations to existing generation business and network business and more for new build projects.

- Operational challenges escalated with Duvha unit 3 boiler and Majuba silo incidents resulting in capacity being removed from the system.

- Rotational load shedding has regularly occurred since November 2014. Government has announced a turnaround plan through the establishment of the Government War Room, spearheaded by the Presidency with a focus on short term resolution of electricity challenges and reduction of load shedding.

2. Government War room interventions

Since the beginning of November 2014, the country has descended into protracted periods of confidence sapping rotational power cuts which are designed to prevent the electricity network from experiencing a total blackout leading to a 5 point plan announced by Government in December 2014 as follows:

1. Raising the availability of its coal-fired plant to above 80%, from 74% currently
2. Harnessing short-term independent power producer (IPP) and cogeneration opportunities.
3. Accelerating programmes to substitute diesel with gas at the open cycle gas turbines (OCGTs), in the Western Cape.
4. Launching coal and cogeneration IPP procurement programmes by the end of January 2015.
5. Managing demand through energy efficiency projects within households, municipalities and commercial buildings.

All of these initiatives will come at a cost which would need to be funded. Eskom's sources of funding comprise equity, debt, operational savings and revenue or a combination. Eskom's revenue is determined by Nersa either through a revenue application or the reopener of the tariff determination for the remaining years of the tariff determination. In the current situation, additional revenue can be achieved through the RCA process that forms part of the MYPD methodology and rules; and through a re-opener of the MYPD3 determination for the remaining period of the MYPD3 period.

This document focus on the selective re-opener for OCGTs and STPPP with the details set out further in the document. Furthermore, this document highlights the impact to customers following the announcement by Minister of Finance during his budget speech 2015 relating to the increase in the environmental levy from 3,5c/kWh to 5,5c/kWh. Finally the overall impact to consumers for 2015/16 is presented.

3. Basis for re-opener

In the original MYPD3 submission assumptions were made around the commissioning dates of Kusile, Medupi and Ingula and the expected performance of the current generation plant, which have since changed. As a result no provision was made for the extensive running of OCGTs and the continuation of the STPPP agreements.

However, since the MYPD 3 application, various factors including the further deterioration of the Generation plant performance; unexpected significant events such as the boiler explosion at one of the Duvha units; the collapse on the Majuba power station silo; challenges with coal quality and delays in commissioning of new build stations have resulted in Eskom having to operate more expensive supply options like the usage of the OCGTs and looking for more short term supply options to close the demand gap. Even though the demand for electricity has not increased as assumed since the MYPD 3 decision, the challenges faced with the supply options have resulted in significant shortfalls.

Eskom has utilised OCGTs extensively in FY2013, FY2014 and it is expected to continue with that in FY 2015 as a last resort manage demand and supply of electricity in the country. The recent load shedding events have cost the economy billions of Rands, created confusion, increased safety risks, increased inconvenience and needs to be addressed. As part of the mechanism to reduced and limit future interruptions the Government War Room led by the Presidency has identified the utilisation of further OCGTs and the extension of Short Term Power Purchase Programme (STPPP) as prioritised deliverables that could have an immediate effect on the stability of the electricity system and contribute meaningfully to reducing the level of load shedding that may need to occur while allowing Eskom headroom to improve Generation performance through execution of the much needed philosophy based maintenance. In addition, contribution can also be made to creating space for vital implementation of Eskom generation maintenance plans to contribute towards sustainability.
Due to Eskom's financial liquidity crunch the organisation is not in a position to undertake these options unless cash inflows are received immediately. Hence the Government War Room has requested Eskom to submit a limited selective re-opener application in terms of the MYPD methodology for the period of 1 April 2015/16 to 31 March 2018. This application request

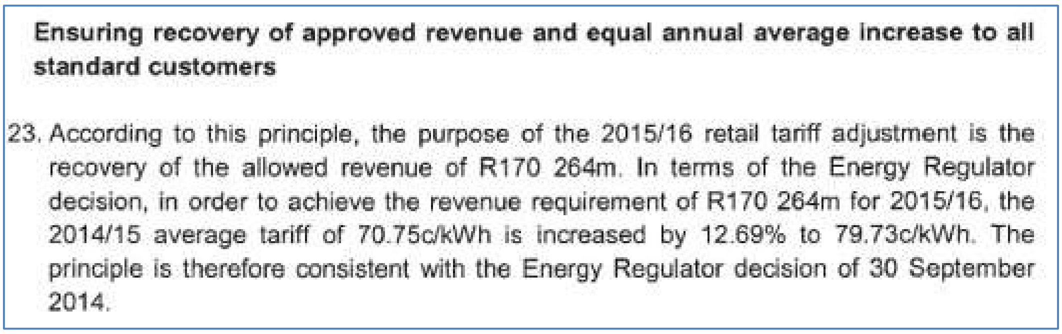
Nersa to make a decision on the allowance for costs relating to OCGTs and STPPP for the last three years of MYPD3. It must be reiterated that the most expensive electricity is having no electricity and the cost of unserved energy to the economy is the most expensive cost for the economy– far higher than the fuel cost for operating OCGTs or STPPP.

A normal full scale re-opener will require a minimum timeframe of between 12~18months from compilation to decision. Thus such a full scale reopener will not be effective in addressing the challenges being faced by South Africa presently. The urgency of the state of the electricity system and financial position requires a quicker and streamlined process, resulting in Eskom being requested to selecting the limited selective reopener.

MYPD2 RCA decision

An extract from the Nersa ERTSA MYPD2 RCA decision is presented below. Eskom will compute the incremental price impact of the selective re-opener and the increase in environmental levy after the 12, 69% decision and thus our reference point for further tariff increases during 2015/16 is 79,73c/kWh.

Figure 1- Extract from MYPD2 RCA implementation decision



Ensuring recovery of approved revenue and equal annual average increase to all standard customers

23. According to this principle, the purpose of the 2015/16 retail tariff adjustment is the recovery of the allowed revenue of R170 264m. In terms of the Energy Regulator decision, in order to achieve the revenue requirement of R170 264m for 2015/16, the 2014/15 average tariff of 70.75c/kWh is increased by 12.69% to 79.73c/kWh. The principle is therefore consistent with the Energy Regulator decision of 30 September 2014.

During the implementation of the MYPD2 RCA decision of R7 818m, Nersa allowed for R7 085m from standard customers and balance from other customers.

Figure 2 - Standard customers impact for MYPD2 RCA decision

7. The updated application is for the recovery of the RCA balance of only R7 085m from standard in addition to the MYPD3 allowed revenue of R163 179m. The updated application is for an annual average standard tariff increase of 11.65%. All the increases are for implementation on 01 April 2015, except the increases applicable to local authorities/municipalities, which are for implementation on 01 July 2015.

4. Summary of selective reopener application

Eskom's selective reopener requires cost recovery of R32,9bn for OCGTs and R19,9bn for STPPP for the period 2015/16 ~2017/18. The OCGTs costs at 450GWh per month equates to a total of R12,5bn per annum. The costs of R12,5bn per annum is then reduced by the Nersa decision of R1,5bn per annum which results in R11bn per annum variance which must be recovered through the price adjustment. From an STPPP perspective, the entire cost must be recovered through the price as the MYPD3 did not allow for any STPPP in the last three years, as Eskom did not submit any amounts in the application. This will require the price of electricity for 2015/16 to increase by 9,58% above the already awarded 12,69% which comes into effect from 1 April 2015 for Eskom direct consumers and 1 July 2015 for municipal customers. Hence consumers will see a combined impact of 22,27% in 2015/16 excluding the impact of the 2c/kWh change in the environmental levy.

Revenue Requirement and Price Increases	2015/16	2016/17	2017/18
Revenue standard tariffs allowed - R862bn (R'm)	163 179	180 070	198 954
Sales per MYPD3 (GWh) 213 545 218 194 223 219 Price c/kWh 76.41 82.53 89.13			
Plus MYPD2 RCA (R'm)	7 085		
Adjusted revenue after RCA decision (R'm)	170 264	180 070	198 954
Price c/kWh after MYPD2 RCA (c/kWh)	79.73		
Selective Re-opener for OCGTs and STPPP (2015/16~2017/18) (R'm)	**16 307**	**16 739**	**17 013**
Adjusted revenue requirements after MYPD2 RCA and Re-opener (R'm) 186 571 196 809 215 967 Price c/kWh after MYPD2 RCA and Re-opener 87.37 90.20 96.75			
Price increase required (%)	**9.58%**	**3.24%**	**7.26%**
Price increase required (%) - OCGTs	6.43%	3.12%	7.35%

Price increase required (%) - STPPP	3.15%	0.12%	-0.09%
* The price increase in 2015/16 is above the 12,69% already announced, thus the absolute increase is 22,27% e levy ** The price increases of 3,24% in 2016/17 and 7,26% in 2017/18 are absolute increases in those years			

Table 1 - Re-opener for OCGTs and STPPP

Assumptions for the computation of price impact

Eskom has used the MYPD3 decision based on the R862bn revenue allowance and corresponding volumes. The revenue for 2015/16 was increased following the MYPD2 RCA decision of R7 818m. However, Nersa allowed for R7 085m to be recovered from standard customers and the balance from other customers. For the purposes of calculating prices in 2016/17 and 2017/18 the regulatory clearing account (RCA) adjustments were assumed at zero as Nersa regulatory processes have not yet been undertaken. NERSA's regulatory rules (MYPD Methodology) allows Eskom to adjust for the over or under recovery of preceding years' regulated costs and revenues through the electricity tariffs in subsequent years. The MYPD methodology requires Eskom, after financial year end, to submit its RCA application to NERSA based on audited financial statements. The RCA is an account used to determine on an annual basis how much of the variances between the assumptions made in the NERSA MYPD decisions compared to the Eskom actuals of revenue and costs will qualify for the RCA balance based on the MYPD methodology.

The amounts requested between 2015/16 to 2017/18 are reduced by the assumption in the MYPD3 determination for OCGTs and STPPP.

Selective Reopener for OCGTs and STPPP (R'm)	2015/16	2016/17	2017/18	Total
OCGTs total costs 12 458 12 458 12 458 37 375 Less OCGTs included MYPD3 decision 4 831	-1 508	-1 599	-1 724	-
OCGTs - costs to be recovered	10 950	10 859	10 734	32 544
STPPP - IPPs costs to be recovered	5 357	5 879	6 279	17 515
Less STPPP costs included in MYPD3 decision	-	-	-	-
STPPP - IPPs costs to be recovered	5 357	5 879	6 279	17 515
Total Revenue requirement adjustment (R'm)	**16 307**	**16 739**	**17 013**	**50 059**
Price increase required (%)	**9.58%**	**3.24%**	**7.26%**	

NOTE
* The price increase in 2015/16 is above the 12,69% already announced, thus the absolute increase is 22,27% excluding change in enironmental levy ** The price increases of 3,24% in 2016/17 and 7,26% in 2017/18 are absolute increases in those years
***The price drop to 3,24% in 2016/17 is due to the adjustment in 2015/16 which increases the base and thus to achieve the original allowed revenue in 2016/17 requires a lower price increase. The 3,24% and 7.26% assumes a no RCA adjustment which would need to be included following regulatory processes.

Table 2 - Revenue requirements and Price increases

5. Open Cycle Gas Turbines (OCGTs)

Production

The forecasted use of the OCGTs power stations reflects an estimated production of 5401GWh per annum at an average of 450GWh per month. OCGTs require approximately 320 litres of diesel fuel to generate 1 MWh of electricity.

OCGTs Production	Months	Nominal Capacity MW	Hours	Load Factor	GWh p.a	GWh p.m
Ankerlig	12	1 327	8 760	29%	3 371	281
Gourikwa	12	740	8 760	29%	1 880	157
Port Rex	12	171	8 760	5%	75	6
Acacia	12	171	8 760	5%	75	6
Total		2 409			5 401	450

Table 3 - OCGTs Production GWh

Using an annual production of 5401 GWh, will result in an additional annual revenue requirement of R12,5bn. As the MYPD3 decision has included an allowance for approximately R1,5bn per annum, the latter is then deducted in this reopener application. From a costing perspective Eskom currently receives a wholesale discount of about 30cents per litre and a diesel rebate of R3,10 per litre. Both these benefits are used to reduce to overall price paid per litre. Understandably if either the rebate or wholesale discount changes over the next 3 years, the differences would need to be addressed through future RCA applications. Thus the price of diesel at the pump is assumed at R10,61 per litre and net price after discount and rebate is R7,21 per litre.

OCGTs Costs		
OCGTs avg production per month	GWh	450
Energy production	GWh	5 401

Litres per MWh	Litres	320
Diesel required	Litres	1 728 256 896
Price of Diesel	R/litre	10.61
Rebate on diesel costs	R3/litre	3.10
Wholesale discount	30c	0.30
Price of Diesel (after rebate)	R/litre	7.21
Cost for OCGTs diesel	Rands	12 458 459 882
Cost for OCGTs per kWh	c/kWh	230.7

Table 4 - OCGTs costs

OCGTs in MYPD3

MYPD3 decision for OCGTs which was assumed in the 8% price decision is indicated below.

Open Cycle Gas Turbines (OCGTs)

Table 24: Approved OCGT Costs for MYPD3

R'm	2012/13 Approved Expenditure	2013/14	2014/15	2015/16	2016/17	2017/18	MYPD 3 Total
OCGT Costs Applied For		3 592	3 258	1 788	1 898	2 056	12 592
OCGT Costs Adjustments		(1 055)	(548)	(280)	(299)	(332)	(2 514)
Approved OCGT Costs	657	2 537	2 710	1 508	1 599	1 724	10 078

Table 5 - OCGTs awarded in MYPD3

Eskom has spent R10561m (3621GWh) in 2013/14 for OCGTs which is more the entire MYPD3 allowance of R10078m. During the second year (2014/15) Eskom had spent R7675m by end January 2015 and projecting to spend R9694m (3653GWh) by end March 2015.

6. Government support for further OCGT usage

Additional funding is required to enable Eskom to run the open cycle gas turbines (OCGTs) at a higher utilisation rate. This will help the company lessen the impact of load shedding and allow for increased generation plant maintenance throughout the year (FY15/16).

In order to enable the procurement of the diesel requirements for FY15/16, Eskom requires approximately R9.5 billion per annum for the remaining MYPD3 period. Any further reduction or increase in the diesel cost per litre would affect the price of future volumes still to be procured.

Eskom had requested assistance from Government for the necessary funding to allow it to procure the required diesel volumes to ensure security of electricity supply for the FY15/16 period, with the possibility of reviewing the funding requirement at the end of FY15/16. National Treasury have confirmed that there are no further cash injections available beyond the already announced cash injections of at least R20bn. The Department of Energy (DOE) supports the high use of OCGTs to avoid load shedding. In the absence of a funding solution Eskom is unable to place orders with the various diesel suppliers using the standard Eskom commercial process. In addition, due to Eskom's already constrained financial situation, a selective reopener route is being pursued. This will allow Eskom to implement the Government War room decisions without the risk of reckless trading.

7. Short Term Power Purchase Programme (STPPP)

Eskom currently utilises the Short-Term Power Purchase Programme (STPPP) power purchase agreements (PPAs), Municipal Generation PPAs and the Medium-Term Power Purchase Programme (MTPPP) PPAs to help balance the supply and demand requirements. These PPAs will all terminate on 31 March 2015 and in order for Eskom to extend the current contracts, Eskom needs to secure funding for these contracts as the financial position is constrained. As clarified under the OCGT section above, assumptions were made on the availability of generators and new build delivery dates without sufficient flexibility for sudden unavailability as experienced with the Duvha and Majuba incidents. Evidently, these did not materialise as planned. It thus becomes necessary for the country to explore whichever viable options are available for further generation. The extension of existing contracts and securing additional IPP contracts are extremely viable options that need to be considered. This has also been identified by the Government War Room is an urgent option to be immediately implemented.

The capacity from these generators is included in the Eskom Capacity Outlook which attempts to balance supply with demand. Should these contracts not be renewed, Eskom will not be in a position to utilise this capacity. Given the tight system supply and demand balance, this will put additional pressure on the Eskom Open Cycle Gas Turbines (OCGTs) and will increase the requirement for load shedding.

Eskom has communicated with all the potential IPP generators and received responses from them confirming their willingness to renew the current contracts. Some generators have even indicated that they have additional capacity to offer Eskom.
The table below shows the maximum contracted capacity for each of the generators contracted in terms of the STPPP, Municipal Generation and the MTPPP as well as the additional capacity offered to Eskom by these generators. These generators have requested contract terms longer than the current one year term.

Information received from current IPP Suppliers			
Supplier	Plant	Existing MW	Additional MW (some with conditions)
SAPPI	Saiccor Mill	9	0

SAPPI	Ngodwana + Tugela	18.1	60
SASOL	Secunda Synfuels	60	40
SASOL	Infrachem	110	0
USM	Umfolozi	5	0
Mpact		5.1	0
PowerAlt		5.1	5.6
Mondi		77	15
City Power		420	
IPSA		13	20
Total		**722.3**	**140.6**

Table 6 - STPPP Capacity

Additional capacity

Table below shows the estimated cost of purchasing this additional capacity over the next three years.

Costs of STPPP of R17515m

In order to enter into these contracts for a period of three years, Eskom needs R17,515 million to be made available as an adjustment of the allowed revenue in the MYPD 3 decision. The costs for these contracts have not been included in the Eskom revenue allocation for MYPD3 and Eskom has no funding available for them and thus have selected the selective reopener approach.

Eskom will contract with these generators using the Eskom standard commercial process.

Name of Supplier	Cost 2015/16 (R'm)	Cost 2016/17 (R'm)	Cost 2017/18 (R'm)	Total
City Power Johannesburg	1 659	1 749	1 854	5 261
Sasol Synfuels Existing	187	197	209	594
SAPPI Ngodwana	29	30	32	91
SAPPI SAICCOR	41	43	46	131
Mondi Limited	327	345	366	1 039
Umfolozi Sugar Mill	32	34	36	103
Power Alt	20	21	22	63
MPACT	28	30	32	90
Sasol Infrachem	445	468	496	1 409
Total Extension costs (R'm)	**2 769**	**2 918**	**3 093**	**8 779**
Additional Capacity				
City of Tshwane	521	550	583	1 653
Sasol Synfuels Gas Additional	1 252	1 319	1 398	3 969
IPSA	68	72	76	217
Sasol Synfuels Coal Additional	87	92	98	277
SAPPI Ngodwana Additional	8	8	9	25

SAPPI Ngodwana 5 Year Additional	3	85	97	185
Power Alt Additional	19	23	24	67
IPSA 5 Year Additional	-	111	118	229
Mondi Additional	-	38	81	119
New enquiry Capacity	629	663	703	1 995
Total Additional	**2 588**	**2 961**	**3 186**	**8 736**
Total Inclusive of Additional (R'm)	**5 357**	**5 879**	**6 279**	**17 515**

Table 7 - STPPP costs of R17,5bn

STPPP in MYPD3

Short Term Power Purchases Programme (STPPP)

Table 33: Approved Short Term Purchases

R'm	2012/13 Approved Expenditure	2013/14	2014/15	2015/16	2016/17	2017/18	MYPD3 Total
Short Term Applied For		1 022	503	-	-	-	1 525
Short Term Adjustments		(0)	(0)	-	-	-	(0)
Approved Short Term	-	1 022	503	-	-	-	1 525

Table 7 - STPPP in MYPD3

The existing Power Purchase Agreements (PPAs) were considered together with the potential of other IPPs that are in MTPPP (after expiration of the agreement) joining the STPPP. Eskom has spent R815m (931GWh) for STPPP in 2013/14 and projecting to spend R1561m (1651GWh) for 2014/15.

8. Environmental levy increase from 3,5c/kWh to 5,5c/kWh

As per the MYPD methodology Eskom is allowed to recover the environmental levy costs from its customers to remain revenue neutral. Hence the levy is treated as pass through items for regulatory purposes. Thus Nersa does not approve the levy which is responsibility of the Minister of Finance, but ensures that the correct amount of revenue is recovered as per amendments to the schedules to the Customs and Excise Act, 1964 by allowing Eskom to increase its tariffs to consumers to recover the additional incremental cost.

Eskom cannot afford to wait for the regulatory clearing account (RCA) mechanism to address this variance as the recovery through the RCA has an approximate two year lag.
Eskom's financial position cannot absorb this time lag and thus the adjustments to tariffs must be implemented to align with the date of implementation of the new levy. For the purposes of computing the impact, Eskom has assumed implementation date of 1 July 2015 (awaiting confirmation of implementation date from National Treasury).

The extract from the Minister of Finance Budget speech 2015 is presented below:

Extract - Further tax proposals (Budget speech 2015)
I am also proposing a number of tax measures to promote energy efficiency, which will be discussed further with industry, the electricity regulator, Eskom and other interested parties. The first proposal is a temporary ***increase in the electricity levy, from 3.5c/kWh to 5.5c/kWh,*** *to assist in demand management. This additional 2c/kWh will be withdrawn when the electricity shortage is over. Secondly, an increase is proposed in the energy-efficiency savings incentive from 45 c/kWh to 95 c/kWh, together with its extension to cogeneration projects. Other measures under consideration include enhancing the accelerated depreciation for solar photovoltaic renewable energy.*

In the absence of a carbon tax, the electricity levy serves both to promote energy efficiency and encourage lower greenhouse gas emissions.

The implication of change in levy assuming that it remains at the 5,5c/kWh for the remainder of the MYPD3 period and based on Eskom projections at February 2015 will require a further R12 729m to be recovered through the price of electricity for Eskom to remain neutral.

Environmental levy (R'm)	2015/16	2016/17	2017/18	Total
Environmental levy projected costs (5,5c/kWh)	13 068	13 180	13 488	39 736
Environmental levy included in MYPD3 decision (3,5c/kWh)	9 300	9 490	9 746	28 536
Environmental levy to be recovered for the 2c/kWh increase	**3 768**	**3 690**	**3 742**	**11 200**

Table 8 - Environmental levy impact after 2c/kWh increase

Impact of levy change on tariffs

The change of 2c/kWh in environmental levy will be passed through onto the consumer. Just this change accounts for the in current price of electricity of 79,73c/kWh increasing to 81,73c/kWh which equates to a 2,5% impact on electricity prices.

Price element	Price impact in 2015/16
Standard tariff after MYPD2 RCA decision	79,73 c/kWh
Impact of change in environmental levy by 2c/kWh	2c/kWh / 79.73c/kWh 2,51%

Table 9 - Impact of change in environmental levy

MYPD3 decision for environmental levy

The allowance for the environmental levy during MYPD3 is disclosed below.

Table 29: Environmental Levy Costs

R'm	2012/13 Approved Expenditure	2013/14	2014/15	2015/16	2016/17	2017/18	MYPD3 Total
Environmental levy Applied For	5 255	8 842	9 037	9 324	9 490	9 746	**46 439**
Environmental levy Adjustments	31	(0)	(1)	(24)	(0)	(0)	**(25)**
Approved Environmental Levy	**5 224**	**8 842**	**9 036**	**9 300**	**9 490**	**9 746**	**46 414**

Table 10 - Environmental levy per MYPD3

9. MFMA Process required for reopener

Whenever Eskom submits an application for any price increase one of the statutory requirements is to comply with the Municipal Finance Management Act (MFMA):

A. ESKOM MFMA requirement – tabling in Parliament before 15 March

1. In terms of section 42 the MFMA, any entity that proposes price increases of bulk resources such as electricity for provision of municipal services, must first submit the proposed amendment to its pricing structure to:
   - its executive authority (Department of Public Enterprises); and
   - to NERSA for approval.

2. The organ of state (Department of Public Enterprises) must, at least 40 days before making a submission request the National Treasury and organised local government (SALGA in this case) provide written comments on the proposed amendment. Eskom is therefore required to submit the application to SALGA and National Treasury for comments before submitting to Nersa for approval.

3. Once approved by Nersa, the amendment and documents must be tabled in Parliament by Eskom's executive authority (Minister of Public Enterprises) prior to implementation to municipal customers.

4. **Unless approved otherwise by the Minister of Finance, an amendment to a pricing structure which is tabled in Parliament**

- **on or before 15 March in any year, does not take effect for the affected municipalities or municipal entities before 1 July in that year; or**
- **after 15 March in any year, does not take effect for the affected municipalities or municipal entities before 1 July the next year.**

To implement any additional price increase by 1 July 2015, if tabled in Parliament after 15 March 2015, will hence require the Minister of Finance (MoF) to grant a postponement of the tabling in Parliament in terms of section 42(5) of the MFMA to ensure that Eskom's executive authority (DPE) is allowed to table after 15 March 2015 and Eskom to implement the revised Municipal tariffs effective 1 July 2015.

In the circumstances, National Treasury was requested to obtain approval from the Minister of Finance that the resultant amended price increase for municipalities be implementedThe changes will still be tabled in Parliament after NERSA approval of the revised Eskom schedule of standard process and before implementation in 2015.

Proposed solution if exemption is provided:

- Eskom to make its submission to NT and SALGA and on the same date they will make a preliminary and unofficial submission to NERSA, to allow NERSA to deal with the information in the submission. The submission will be clearly marked as "preliminary and unofficial, pending comments from NT and SALGA".
- Although the Act stipulates that NT and SALGA should be given "at least 40 days" they can be requested to provide their comments with 20 days (or as determined by the Government War Room);

- As soon as comments are received from NT and SALGA, Eskom's submission will be amended accordingly, indicating how said comments have been taken into account. An official application will then be lodged with NERSA.
- NERSA is requested to publish the submission for the minimum allowable period (30 days) after which a public hearing is scheduled and a decision made.

It will require co-operation and support from several parties to achieve a 1 July 2015 implementation.

B. MFMA and PAJA requirements – applicable to municipalities

The deadline required by NERSA (15 March 2015) to finalise the municipal tariffs would not be met. As a result it will require Minister of Finance (MoF) to grant postponement in terms of section 43 (2) to ensure that municipalities still implement new tariffs on 01 July 2015.
NERSA to apply for the postponement of finalisation of municipal budgets.

Indicative timeline for 1 July implementation

The MFMA requirements that require a submission to SALGA and National Treasury for comments before submitting to Nersa may affect the target implementation date of 1 July. If so, it seems a target date could be 1 September 2015. Alternatively, significant buy- in is required to meet 1 July under the aggressive timeline proposal. Both options will require special exemption from Minister of Finance regarding requirements of MFMA. This is due to the MFMA requiring the tabling of price increases for Municipalities by 15 March and the reopener decision will be made after 15 March.

Figure 3 - Indicative timeline meets 1 September

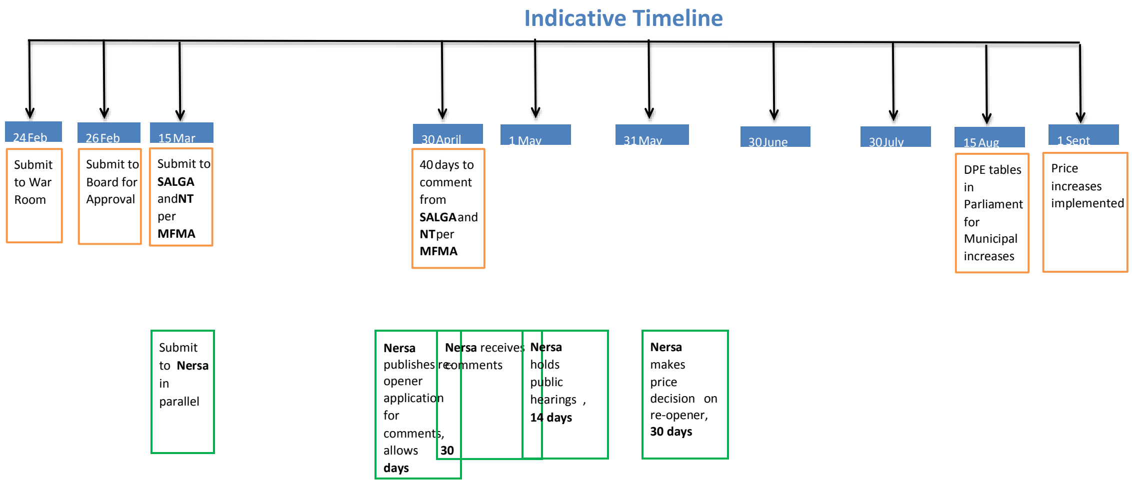
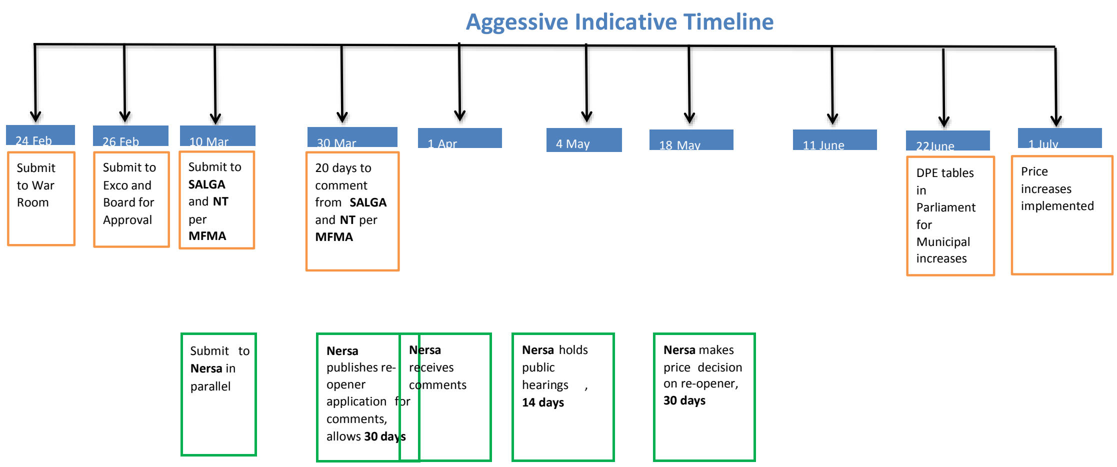


Figure 4 - Aggressive indicative timeline to meet 1 July



10. Conclusion

Eskom requires certainty of cash flows relating to recovery of OCGTs and STPPP costs for the remaining three years of MYPD3. Eskom would have spent approximately R20bn on OCGTs by the end of the two years of MYPD3 which exceed the full five year MYPD3 allowance of R10bn. Furthermore there is no allowance for STPPP in the last 3 years of MYPD3. Hence Eskom has opted for the selective reopener for OCGTs and STPPP which requires a cost recovery of R32,9bn for OCGTs and R19,9bn for STPPP to end of MYPD3 period. This selective reopener will cause the price of electricity to increase by an additional 10,10% in 2015/16.

In addition to the normal annual tariff increase for 2015/16, customers will be impacted by three specific price elements in 2015/16 comprising the MYPD2 RCA, selective reopener and environmental levy change as follows:

Price element	Price impact in 2015/16
MYPD2 RCA decision including liquidation	12,69%
Selective Re-opener for OCGTs and STPPP	10,10%
Impact of change in environmental levy by 2c/kWh	2,51%
Total price impact to customer in 2015/16	**25,30%**

Table 11 - Overall impact to consumers in 2015/16

Eskom's request is that the revenue requirement be adjusted during the 2015/16 financial year which equates to price adjustment of 9,58% which is in addition to the already announced 12,69% for 2015/16. The flow through to prices excluding any future RCA adjustments will result in the price of electricity dropping to 3,24% in 2016/17 and increasing to 7,26% in 2017/18.

To achieve the MYPD3 price increase of 8% would require future RCA decisions of R9,5bn in 2016/17 and R12,0bn in 2017/18. Alternatively to achieve the price increase assumption of 13% in the Government support package will require future RCA decisions of R19bn in 2016/17 and R34bn in 2017/18.

11. Comments in terms of the MFMA

The Selective Reopener is subject to Section 42(2) of the Municipal Finance Management Act (MFMA). which prescribes the processes to be followed by a national organ of state which supplies water and electricity (or any other bulk resource as may be prescribed) to a municipality or municipal entity for the provision of a municipal service if it intends to increase the price of such resource for the municipality or municipal entity. Specifically, Section 42(2) of the MFMA requires an organ of state to request the National Treasury and SALGA to provide written comments on the proposed amendment at least 40 days before submitting an application for a pricing structure amendment to its executive authority and regulatory agency.

12. Summary of SALGA comments

Impact of further price increases

SALGA asserts that implementing the selective reopener will result in further increasing nonpayment and electricity theft. Both of these will negatively affect municipalities and will in turn lead to more distributing municipalities defaulting on their bulk electricity payments to Eskom. It is proposed that a less steep path of price increases should be considered. SALGA is committed to the financial viability and long term sustainability of Eskom. SALGA proposes that the end customer has a burden of a higher than inflationary tariff increase to bail out the utility. This is deemed unfair, unaffordable and unjustified.

Local Government budget approval process and implementation

Local government has significant public participation processes to follow to get a budget approved and implemented. Even if expenditure continues based on the approved budget for the previous year, it is clear that the delays in reworking budgets to accommodate the tariff increase would have a negative effect on public participation communication strategies as well as ultimately, longer term service delivery, repairs and maintenance as well as refurbishment spending patterns. For any additional increase, municipalities should be allowed a percentage increase and provision must be made to deviate from the current Constitutional and MFMA requirements.

Economic impact

SALGA is unclear of what the impact of not having electricity is on the economy and the cost of unserved energy is not highlighted or quantified. Whist the inconvenience of not having electricity is understood, further information is required to justify the re-opener on the basis of costs to the economy and costs of unserved energy.

Funding Model

It is unacceptable that further equity has not been allowed by National Treasury. Whilst the constraints of national funding are acknowledged, Treasury must formulate innovative ways of providing funding during these times of constraints. Eskom downgrade is acknowledged, however further information on the limits of borrowings or the cost of capital is needed. Whilst the business productivity programme has been initiated to promote internal savings, there is little commitment and lack of strict and harsh penalties should these not occur.

13. Summary of National Treasury comments

STPPP

National Treasury understands that NERSA has already given written in-principle approval to Eskom that the STPPP costs for 2015/16 will be passed through to the tariff. The use of the STPPPs is supported to urgently secure as much power as possible and that they offer a more cost-effective way of meeting base-load demand than the OCGTs.

Increased use of OCGT

Although in-principle support was articulated by Government to use OCGT's to prevent loadshedding, it does not release Eskom from having to motivate the exact levels of OCGTs to be used. Eskom should motivate to Nersa the expected shortage, the extent to which this can be met through other more cost-effective means, and lastly, the remaining amount that OCGTs are intended to fill.

Environmental levy

National Treasury is still giving consideration to the implementation of the 2 cents increase in the environmental levy as proposed in the Budget. It would be prudent for Eskom to continue to include this in its Selective Reopener.

Importance of immediate tariff increases for Eskom's financial sustainability

National Treasury recognises Eskom's weak financial position resulting in a Government Support Package and the downgrade of Eskom's investment grade rating by rating agencies. A key aspect of Eskom's return to a healthy financial position is increasing tariffs to reflect the long run marginal cost of electricity. Immediate adjustments would assist with the current liquidity challenges, and help Eskom's overall financial position to begin strengthening towards a financially sustainability. Tariff adjustments are the foremost instrument for improving the company's financial metrics, all of which are currently far below levels considered to be adequate, even for a state-owned entity that receives financial support from Government. Hence, tariff adjustments would boost investor confidence in South Africa's commitment to reaching 'cost-reflective tariffs', and thus the organisation's investment-worthiness and basic ability to repay debt. Such increased confidence is key for investor confidence, allowing Eskom to access additional debt at reasonable cost levels. At present this access is becoming constrained.

Cost containment and debt collection

Tariff increases will not be successful on their own in returning Eskom to full financial health, and such increases must be accompanied by a commitment by Eskom to greater costcontrol and debt-collection.

Economic impact

National Treasury considers that tariff increases will have a significant negative impact on the economy. The increases are justifiable based on costs and liquidity requirements of Eskom. An assessment needs to be made on whether cost reflectivity would be achieved. It is recognised that significant tariff increases are critical to prevent higher levels of loadshedding. It is estimated by National Treasury that the cost to the economy of load-shedding is as much as R9 to R15 per kWh. Given the high economic and social cost of loadshedding, it is critical that cash inflows be secured to support supply measures.

Selective reopener for 2015/16 year only be considered

National Treasury recommends that only increases for the 2015/16 year are approved out of the Selective Reopener process, and that further tariff increases for the following years only be considered once there is substantial information to hand on what the potential level of the 'cost-reflective' or long-run marginal cost tariff level is.

Commitment from all parties

For a tariff adjustment is to take effect from 1 July 2015, all players would need to commit to expediting their respective processes as far as possible to assist with the 15 May 2015 deadline.

END