

NERSA Consultation Paper

The Eskom application for a two-year incentive pricing package for Sublime Technologies Proprietary Limited (Pty) Ltd's silicon carbide production facility at Kriel in Mpumalanga

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ANNEXURE A: ESKOM'S APPLICATION FOR A TWO-YEAR PRICING PACKAGE FOR THE SUBLIME TECHNOLOGIES (PTY) LTD SILICON CARBIDE PRODUCTION FACILITY IN KRIEL, MPUMALANGA

ANNEXURE B: THE NEGOTIATED PRINCING AGREEMENT INTERIM FRAMEWORK

1. INTRODUCTION

In terms of the Electricity Pricing Policy 2008, Negotiated Pricing Agreements (NPAs) are regulated in accordance with the Electricity Pricing Policy Position 14 to guide South African's electricity industry.

Policy Position 14

- a) *NPAs are permitted, but must be structured in a way so as to minimise price distortions.*
- b) *Commodity price risk exposure must be hedged outside of the ESI.*
- c) *Existing NPAs will be honoured until the end of contract.*
- d) *The evaluation of NPAs at inception must be based on the cost of supply (excluding cross-subsidies) on a discounted cash flow basis over the period of the agreement.*
 - *The cost of supply for NPAs intended for the sale and consumption of electricity in South Africa must be defined by the electricity price forecast, which will be based on the prevailing regulatory methodologies in South Africa inclusive of an appropriate risk premium.*
- e) *DoE must develop a transparent NPA application and approval process to ensure adequate evaluation and consultation with key stakeholders including National Treasury.*
- f) *DoE must update the NPA pricing framework setting out the evaluation criteria. NERSA will approve and monitor NPAs in accordance with the framework.*
- g) *All applications must be treated in accordance with the approved processes and frameworks and be approved by NERSA.*

The Energy Regulator is embarking on a process of evaluating an NPA between Eskom and Sublime Technologies (Pty) Ltd. This is the second evaluation of this NPA application.

2. EXECUTIVE SUMMARY

Economic growth contracted to -0.7% in the first quarter of 2017, leading the economy into a technical recession. A key element of its recovery will be the promotion of industrial activity and job retention. Competitively priced electricity for key industries, coupled with stronger consumer and business demand, will play a critical role in South Africa's recovery.

According to Eskom, due to low international demand for commodities and sluggish growth, large industry and electricity intensive users' operating environment has been marked by, among other things, diminished competitive advantage due to the sharp increase in electricity prices. This has decreased production viability in South Africa, resulting in the geographic reallocation of production at the expense of jobs and gross domestic product (GDP) growth in South Africa.

Eskom predicts they will experience a surplus capacity that will peak at about 14 000 MW within the next few years, yet currently their sales have decreased, placing an additional burden on the consumer because it increases the electricity prices.

The challenge is that on the one hand, there are energy intensive industries that are struggling to survive, and on the other Eskom is experiencing a surplus of capacity and needs to sell more electrical energy to cover its fixed costs. Given this situation, Eskom has submitted an NPA application to NERSA for approval. The rationale behind the NPA is to promote economic growth and save jobs, while selling more electricity, thereby reducing the upward pressure on electricity prices for all other consumers.

This can only be achieved if Eskom's selling price exceeds the marginal operating cost of electricity and is subjected to limiting conditions to protect other customers from subsidising them.

NERSA is aware that there are also other risks to such contracts and wishes to achieve the benefits for South Africa while preventing a negative impact on other customers.

NERSA invites all stakeholders to comment on this NPA.

3. BACKGROUND

Sublime Technologies (Pty) Ltd ('Sublime') is South Africa's only silicon carbide (SiC) producer, situated in Kriel, Mpumalanga and Sublime's beneficiation is of 100% South African raw materials. Sublime's SiC production is energy intensive in that electricity makes up >50% of the costs. It competes in the global market, having no direct competitors in South Africa and its businesses is strongly influenced by South Africa's industry global cost competitiveness.

A primary SiC industry leads to the establishment and/or growth of numerous downstream industries including, but not limited to, foundries and stainless steel producers. Sublime Technologies (Pty) Ltd has developed local sales of SiC of between 8,000 and 12,000 tons per year over the last five years. Sublime Technologies (Pty) Ltd believes it will be possible for the local consumption to grow to 40,000 tpa in the future. Competitively priced local production of SiC will also ensure the financial viability and growth of downstream users of SiC.

Sublime Technologies (Pty) Ltd has been involved in the development of Eskom's demand response products. Over the past 7 years, they have participated in the supplemental demand response product with participation of 30 MW. Sublime Technologies (Pty) Ltd also participated in the power-buyback initiative during the 2012/13 financial year.

Sublime Technologies (Pty) Ltd is currently operating at 50% capacity (since 2015) and the avoidance of a complete shutdown of operations would prevent the retrenchment of a further 108 people. Sublime Technologies (Pty) Ltd has been operating at a loss and is at risk of closure.

In light of the above, Sublime Technologies (Pty) Ltd approached Eskom for relief regarding its electricity prices and entered into an NPA.

4. DISCUSSION

Electricity demand has declined in South Africa since 2007, with the biggest drop occurring in the industrial sector. This has become a major expense to the consumer, because Eskom still has to recover its fixed costs, which has resulted in it being a major portion of Eskom's Regulatory Clearing Account (RCA) applications.

This decline in demand, together with the commissioning of Eskom's new generators and the Renewable energy programme, has created an environment where excess capacity is now available on the system.

An NPA can be defined as a bilateral contract of defined length (duration) for supply of electricity to an eligible customer from a supplier or intermediary.

The Energy Regulator received a marginal cost pricing/discounted tariff NPA application from Eskom. According to Eskom, this application is aimed at stimulating additional demand (**Annexure A**).

Eskom states that the main objectives of this NPA are:

- to reinstate the production of silicon carbide at the production facility owned by Sublime Technologies (Pty) Ltd for at least two years,
- to increase Eskom's sales volume and revenue; and
- to prevent 108 job losses, which would occur if Sublime Technologies (Pty) Ltd ceases production.

The application is for a two-year period, with a reduced rate to be adjusted by the South African Producer Price Index twelve months after approval by the Energy Regulator.

In South African's electricity industry, the NPAs are regulated in terms of the Electricity Pricing Policy (EPP) 2008.

It is worth noting that the Minister of Energy developed an interim framework (**Annexure B**) that was specifically designed for Silicon Smelters (Pty) Ltd and Sublime Technologies (Pty) Ltd.

However, this is an interim arrangement while the department is embarking on a wider pricing framework for the other sectors in similar situations.

Given the current economic climate, NERSA envisages that there will be more of these kind of applications due to the following reasons:

- The NPA is being evaluated for the second time (it is not an extension or review), therefore the consideration of Sublime's application must be in line with Silicon Smelters' approved NPA.
- The cost of supply over the period of the agreement is necessary and it is not provided.
- The application and approval process has not been provided by the Department of Energy.

Given the Promotion of Administrative Justice Act, 2000 (Act No. 3 of 2000) ('PAJA') rules, NERSA will use the following principles in accessing this application:

- The time period of these applications
- The tariffs' marginal cost of supply
- The economic impact
- The pricing structure
- The level of participation in the demand response market.
- The level of incremental sales
- The system's security

5. STAKEHOLDER INPUT

Stakeholder input:

- a) Please comment on the proposed NPA, its structure, fairness and impact. Please substantiate your response.
- b) Please comment on NERSA's proposed assessment principles. Please substantiate your response.
- c) If it is your view that an alternative solution should be used, please provide the alternate solution and detail how this solution should be applied. Please substantiate your response with examples, if possible.

6. CONSULTATION PROCESS TO BE FOLLOWED

NERSA is in the process of reviewing Eskom's application for a two-year incentive pricing package for Sublime Technologies (Pty) Ltd's silicon carbide production facility at Kriel in Mpumalanga, with the aim of finalising it by 25 July 2018. However, prior to the decision, the Energy Regulator will embark on a due process involving stakeholder consultations. As part of this process, NERSA is requesting that stakeholders comment on the issues raised in this consultation paper.

NERSA will collate all comments received, which will be taken into consideration when the decision is made. The process for the consultation and decision-making is outlined in the table below.

Table 1: The proposed consultation and approval process

DRAFT HIGH-LEVEL TIMELINES FOR THE APPROVAL PROCESS	
ACTIVITY/TASK	DATE
Publication of draft consultation paper for stakeholder comments on the Eskom application for a two-year incentive pricing package for Sublime Technologies (Pty) Ltd in Kriel, Mpumalanga	16 May 2018
Closing date for stakeholder comments on the application.	5 June 2018
Energy Regulator decision.	10 July 2018
Publication of the Reasons for Decision on the NERSA website	25 July 2018

7. CONCLUSION

Comments are requested from the members of the public on the NPA application. Comments must be submitted in writing to:

Post: Attention: Mr Majafela Modise/Ms Kwena Matlou
 The National Energy Regulator of South Africa
 PO Box 40343
 Arcadia
 Pretoria
 0007

Email: EskomNPAAplication@nersa.org.za

Tel: 012 401 4600

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The closing date for submission of comments is close of business on 5 June 2018.