



CONSULTATION PAPER

ESKOM RETAIL TARIFF AND STRUCTURAL ADJUSTMENT METHODOLOGY

Issued by
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Contents

- ABBREVIATIONS AND ACRONYMS3**
- THE CONSULTATION PROCESS.....4**
- 1 INTRODUCTION.....5**
- 2 LEGAL BASIS5**
- 3 APPLICABILITY OF ERTSA METHODOLOGY6**
- 4 ALLOWED REVENUE BASED ON MYPD6**
- 5 ESKOM ANNUAL RETAIL TARIFF AND STRUCTURAL ADJUSTMENT7**
- 6 IMPLEMENTATION OF LOCAL AUTHORITY INCREASE.....8**
- 7 CROSS-SUBSIDIES AND RETAIL TARIFF STRUCTURAL ADJUSTMENTS11**
- 8 ADJUSTMENT OF THE APPROVED SCHEDULE OF RETAIL TARIFF13**
- 9 REVIEW AND MODIFICATION OF THE METHODOLOGY14**

ABBREVIATIONS AND ACRONYMS

EPP	Electricity Pricing Policy
ERTSA	Eskom Retail Tariff and Structural Adjustment
MFMA	Local Authority Finance Management Act
MYPD	Multi-Year Price Determination
NERSA	National Energy Regulator of South Africa
RCA	Regulatory Clearing Account

THE CONSULTATION PROCESS

The National Energy Regulator of South Africa (NERSA) is in the process of developing a methodology with the aim of finalising it by 28 January 2016. However, prior to the decision, NERSA has to consult stakeholders. As part of this process, NERSA is inviting stakeholders to comment on the issues raised in this consultation paper. The consultation paper is broken down into sections relating to the key elements/components that make up the final annual average tariff increase to standard customers.

NERSA will take all comments received into consideration when making the decision. NERSA will also hold a public hearing on 03 December 2015 where presentations may be made by interested and/or affected parties. The process for the consultation and decision-making is outlined in Table 1 below.

Table 1: Timelines for approval of the annual retail tariff adjustment

DRAFT HIGH-LEVEL TIMELINES FOR APPROVAL OF THE RETAIL TARIFF ADJUSTMENT METHODOLOGY	
ACTIVITY/TASK	DATE
Publication of draft methodology for stakeholder comments	15 October 2015
Closing date for stakeholder comments	16 November 2015
Public Hearing	03 December 2015 ¹
Electricity subcommittee	12 January 2016
Energy Regulator decision	28 January 2016
Communication and Publication of the methodology	01 February 2016

Stakeholders are requested to, in writing, comment on the proposed Eskom Retail Tariff and Structural Adjustment Methodology Consultation Paper. Written comments can be forwarded to erts@nersa.org.za; hand-delivered to Kulawula House, 526 Madiba Street, Arcadia, Pretoria; or posted to PO Box 40343, Arcadia, 0083, Pretoria, South Africa. The closing date for the submission of comments is 16 November 2015 at 16:00.

For more information and queries on the above, please contact Ms Porcia Makgopela or Mr Frank Hinda on the below details.

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1 INTRODUCTION

1.1 NERSA approves Eskom's Multi-Year Price Determination (MYPD) allowed revenue for a particular period (MYPD cycle). The MYPD allowed revenue is, for each of the respective years of the MYPD cycle, based on forecasted average energy demand. Based on the Energy Regulator's determination, Eskom is then required to annually submit its retail tariff adjustment application to NERSA. The Eskom Retail Tariff and Structural Adjustment (ERTSA) will consist of an application to adjust the tariffs applicable to the respective customer groups, as well as the proposed schedule of standard tariffs applicable to each of the customer groups for each year of the MYPD. The ERTSA is applicable to Eskom's local authority and non-local authority customers. Prior to the implementation of retail tariffs, Eskom has to table the approved schedule of standard tariffs to parliament by 15 March every year [as required by the Local Authority Finance Management Act (MFMA)] (Act No. 56 of 2003) for concurrence before implementation on 01 April for non-local authority and 01 July for local authority customers.

2 LEGAL BASIS

2.1 The legal basis for the methodology lies in the Electricity Regulation Act, 2006 (Act No. 4 of 2006) ('the Act'). Section 4(a)(ii) of the Act states that *the Regulator must regulate prices and tariffs*. Further, sections 15 (1) and (2) of the Act prescribe the following tariff principles:

- (1) *A license condition determined under section 14 relating to setting or approval of prices, charges and tariffs and the regulation of revenues –*
 - a) *Must enable an efficient licensee to recover the full cost of its licensed activities, including a reasonable margin or return;*
 - b) *Must provide for or prescribe incentives for the continued improvement of the technical and economic efficiency with which the services are to be provided;*
 - c) *Must give end users proper information regarding the costs that their consumption imposes on the licensee's business;*
 - d) *Must avoid undue discrimination between customer categories; and may permit the cross-subsidy of tariffs to certain classes of customers.*
- (2) *A licensee may not charge a customer any other tariff and make use of provisions in agreements other than that determined or approved by the Regulator as part of its licensing conditions.*

- 2.2 In terms of the Local Authority Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), tariff increases to local authorities can only be implemented at the beginning of the local authority's financial year, namely 01 July.
- 2.3 Apart from the Act, the Electricity Pricing Policy (*Electricity Pricing Policy GN 1398 of 19 December 2008*) (EPP) gives broad guidelines to the Energy Regulator in approving prices and tariffs for the electricity supply industry.

3 APPLICABILITY OF ERTSA METHODOLOGY

- 3.1 The Methodology shall be applicable to the determination of the Eskom Retail Tariff and Structural Adjustment (ERTSA) and the associated schedule of approved standard tariffs for a particular year of the MYPD.

4 STANDARD CUSTOMER ALLOWED REVENUE BASED ON MYPD

- 4.1 Eskom's allowed revenue is determined by the Energy Regulator for a predefined MYPD cycle. The standard allowed revenue is the revenue that Eskom is allowed to recover from its standard customers in a particular year.
- 4.2 The forecasted sales volumes to Eskom standard customers are determined for each of the respective years of the MYPD cycle, in conjunction with the allowed revenue for each of the respective years will be used for purposes of ERTSA.
- 4.3 The forecasted sales volumes for each year remain constant for the duration of the MYPD cycle.
- 4.4 The allowed revenue from standard customers for each year remains constant for the duration of the MYPD cycle unless adjusted by the Energy Regulator for the purpose of implementing a Regulatory Clearing Account (RCA).

Stakeholder Question 1:

- a) Stakeholders are requested to comment on whether Eskom should be allowed to adjust the forecasted sales volume in the middle of a MYPD cycle, for the purpose of implementing ERTSA.

b) Stakeholders are requested to comment on whether the allowed revenue for the application year will have to be adjusted if Eskom is allowed to adjust the forecasted sales volume in the middle of a MYPD cycle, for the purpose of implementing ERTSA.

5 ESKOM ANNUAL RETAIL TARIFF AND STRUCTURAL ADJUSTMENT

- 5.1 The Eskom annual average tariff increase for each year of the MYPD cycle is as determined by the Energy Regulator in the MYPD.
- 5.2 Therefore, the ERTSA (rate of adjustment) for the annual average increase for both local authority and non-local authority customers is as determined by the Energy Regulator in the MYPD.
- 5.3 The Energy Regulator may, for the purpose of implementing a regulatory clearing account balance, adjust the annual average tariff increase for a particular year within a MYPD cycle.
- 5.4 The forecasted sales volume and allowed revenue from standard customers for the year to which the ERTSA application relates will be as determined by the Energy Regulator as part of the MYPD.
- 5.5 The Eskom financial year to which the ERTSA application relates is referred to as the 'application year'.
- 5.6 The Eskom financial year preceding the application year is referred to as the 'base year'.
- 5.7 The overall average standard tariff for the base year is determined by dividing the allowed revenue for the base year by the forecasted volumes for the same year as per the MYPD.
 - I.
$$\text{Base year average standard tariff} = \frac{\text{Base year allowed revenue}}{\text{Base year forecasted sales volumes}}$$
- 5.8 The average standard tariff for the base year for each of the respective Eskom customer groups is determined by dividing the respective allowed revenue for the base year by the respective forecasted volumes for the same year as per the MYPD.

5.9 In order to determine the average tariff for the application year, the base year average tariff of respective customer groups is increased by ERTSA, determined as part of the MYPD, before considering any form of cross-subsidy.

II.
$$\text{Application year average standard tariff} = \text{Base year average standard tariff} \times \text{ERTSA}$$

5.10 The average tariff for the application year is multiplied by the corresponding forecasted sales volumes, so that the allowed revenues for the application is recovered.

III.
$$\text{Application year allowed revenue} = \text{Application year average standard tariff} \times \text{application year allowed volumes}$$

5.11 ERTSA is the rate of increase that has to be applied to the base year schedule of approved tariffs for non-local authority customers before consideration of any form of cross-subsidy or structural adjustment.

Stakeholder Question 2:

Stakeholders are requested to comment on whether the annual average increase in allowed revenue can be the same as the annual average tariff increase if the sales volume is forecasted to grow in the application year when compared to the forecasted sales volume for the base year.

6 IMPLEMENTATION OF LOCAL AUTHORITY INCREASE

6.1 The annual average allowed revenue from local authorities is as determined by the Energy Regulator as per paragraph 5.2.

6.2 The ERTSA applicable to local authority customers has to be implemented at the beginning of the local authority financial year (01 July), which is three months into the application year.

6.3 Eskom should, however, recover all MYPD allowed revenue from local authorities by the end of the application year.

6.4 The ERTSA applicable to local authority customers is the annual average increase adjusted so that the total local authority allowed revenue for the particular year is recovered in full by the end of Eskom's financial year.

6.5 In order to determine the allowed revenue recoverable from local authority customers for the first three months of the application year, the schedule of approved tariffs (Local Authority customers) for the base year shall be applied to the Local Authority forecasted sales volumes for the first three months of the application year.

IV. Application year three-month allowed revenue = Base year schedule of approved tariffs x Forecasted sales volumes for the first three months of the application year

6.6 The balance of the local authority allowed revenue for the application year should be recovered during the remaining nine months of the application year. The revenue recoverable over the nine months is the difference between the total annual allowed revenue (application year) from local authority customers and the revenue recoverable during the first three months of the application year.

V. Application year nine-month allowed revenue = Application year total allowed revenue – Application year's three-month allowed revenue

6.7 The average tariff for local authority customers for the nine months is determined by dividing the nine-month allowed revenue for the application year by the forecasted sales volumes for the same period of the application year.

VI. Application year nine-month average tariff = Application year nine-month allowed revenue ÷ Application year nine-month forecasted sales volume

6.8 The rate of the nine-month average increase to local authority tariffs (adjusted ERTSA), is the percentage increase in local authority nine-month average tariff for the application year when compared to the nine-month average local authority tariff in the base year.

VII. Application year nine-month average tariff increase (%) = Application year nine-month average tariff ÷ Base year nine-month average tariff - 1

6.9 The revenue recoverable over the last nine months of the base year is the difference between the base year total annual allowed revenue from local authority customers, reduced by the amount recoverable during the first three months of the same year.

$$\text{VIII. Base year nine-month allowed revenue} = \text{Base year total annual allowed revenue} - \text{Base year three-month allowed revenue}$$

6.10 The nine-month average tariff for the base year is determined by dividing the revenue recoverable over the period by the forecasted sales volume for the same period of the base year.

$$\text{IX. Base year nine-month average tariff} = \frac{\text{Base year nine-month allowed revenue}}{\text{Base year nine-month forecasted sales volume}}$$

6.11 The revenue recoverable in the first three months of the base year is determined by applying the schedule of tariffs for the year preceding the base year on the forecasted sales volume for the first three months of the base year.

$$\text{X. Base year three-month allowed revenue} = \text{Schedule of approved tariffs for the year preceding the base year} \times \text{Base year three-month forecasted sales volumes}$$

6.12 The adjusted ERTSA is the rate of increase that has to be applied to the local authority base year schedule of approved tariffs before consideration of any form of cross-subsidy or tariff structural adjustment.

6.13 The example below is an illustration of the calculation of the nine-month municipal ERTSA. The calculation in Table 2 is premised on the assumption that an annual average tariff of 16.0% in the application year and annual average increase of 9.0% in the base year are used in the calculation of the nine-month average tariff increase of 18.1% for local authority customers.

Table 2: Illustrative local authority annual average increase

Base Year						
	GWh	R'm	c/kWh			
Apr-Jun	24 476	15 053	61.50			
Jul-March	71 796	48 929	68.15			
	96 272	63 983	66.46			
Application Year				Increases		Growth
	GWh	R'm	c/kWh	Tariff	Revenue	Volume
Apr-Jun	25 066	16 804	67.04	9.0%	11.6%	2.4%
Jul-March	73 757	59 382	80.51	18.1%	21.4%	2.7%
	98 823	76 186	77.09	16.0%	19.1%	2.6%

Step 1: The application year total allowed revenue from local authority customers of R76 186m is as determined by the Energy Regulator.

Step 2: Application year three-month allowed revenue (R16 804m) is determined by applying the base year schedule of approved tariffs on the forecasted sales volume of 25 066GWh for the first three months of the application year.

Step 3: Application year nine-month allowed revenue of R59 382m is determined by subtracting the three-month allowed revenue of R16 804m from the total annual local authority allowed revenue of R76 186m for the application year. i.e. $R59\ 382m = R76\ 186m - R16\ 804m$.

Step 4: Application year nine-month average tariff of 80.51c/kWh is determined by dividing the application year nine-month allowed revenue of R59 382m by the application year nine-month allowed volume of 73 757GWh.

In order to complete steps 5 and 6, the base year nine-month allowed revenue, base year nine-month average tariff and base year three-month allowed revenue should be used. The base year data is as determined as part of the previous year's ERTSA determination.

Step 5: Application year nine-month average tariff increase of 18.1% is determined by dividing the application year nine-month average tariff of 80.51c/kWh by the base year nine-month average tariff of 68.15c/kWh minus one.

Step 6: Application year nine-month average tariff increase of 18.1% is the rate of increase applied on the base year local authority schedule of approved tariffs before consideration of any cross-subsidy or structural adjustment.

Therefore even though the local authority average tariff increase (18.1%) is implemented on 01 July of the application year, the annual average tariff increase over the application year remains 16.0% only. This is because the average increase for local authority customers for the first three months into the application year is 9.0% and 18.1% for the remainder of the application year. The weighted average increase for the application year is therefore only 16.0%. The 18.1% tariff increase to local authority customers will however, remain in place for three months into the subsequent Eskom financial year.

Stakeholder Question 3:

- a) Stakeholders are requested to comment on whether, in instances where Eskom is not allowed to implement a tariff increase at the beginning of its financial year (i.e. local authority tariff increase), it will be necessary to, when implementing, adjust the annual average increase to such customers in order for Eskom to recover all customer-specific allowed revenue by the end of its financial year.
- b) In the case of local authority customers, for three months into its new financial year Eskom may not subject the schedule of approved tariffs applicable to local authority customers to the annual average increase. Stakeholders are therefore requested to comment on whether this implies that the local authority customers will, for the first three months of the application year, be subjected to the same tariff that was applicable for the first three months of the base year.
- c) Stakeholders are requested to comment on whether the fact that the schedule of tariffs for local authority customers at the end of the base year remains in place for three months into the application year, amounts to a zero annual average increase to Local Authority customers for the first three months of the application year, when compared to the schedule of tariffs application for the first three months of the base year.
- d) Stakeholders are requested to comment on whether the fact that for three months into the application year, there is no month-to-month increase in Local Authority schedule of approved tariffs, is relevant to the calculation of the annual average tariff adjustment to Local Authority schedule of approved tariffs for the application year.

7 CROSS-SUBSIDIES AND RETAIL TARIFF STRUCTURAL ADJUSTMENTS

- 7.1 The Energy Regulator may, as part of the MYPD, allow cross-subsidies between various customer groups.
- 7.2 Cross-subsidies approved by the Energy Regulator should be implemented as part of the annual average tariff increase to affected customer groups. The implementation of cross-subsidies may therefore result in changes to the non-local authority ERTSA and/or the local authority ERTSA for affected customer groups.
- 7.3 The Energy Regulator may, as part of the MYPD, allow structural adjustments to retail tariffs to a particular group of customers.
- 7.4 Tariff structural adjustments approved by the Energy Regulator should be implemented so that, on average, they do not result in further adjustment to either the local authority or non-local authority ERTSA.

Stakeholder Question 4:

Stakeholders are requested to comment on whether structural adjustment to the schedule of tariffs should be allowed to cause changes in the annual average tariff increase to affected customers.

8 ADJUSTMENT OF THE APPROVED SCHEDULE OF RETAIL TARIFF

- 8.1 The schedule of approved tariffs for the base year for non-local authority customers should, on average, be adjusted by the non-local authority ERTSA to give effect to the annual average tariff increase. The non-local authority schedule of approved tariffs should, when required, be subjected to further adjustment to give effect to any form of cross-subsidies and/or structural adjustment as may be approved by the Energy Regulator.
- 8.2 The schedule of approved tariffs for the base year for local authority customers should, on average, be adjusted by the Local Authority ERTSA to give effect to the nine-month average tariff increase. The Local Authority schedule of approved tariffs should, when required, be subjected to further adjustment to give effect to any form

of cross-subsidies and or structural adjustment as may be approved by the Energy Regulator.

- 8.3 The schedule of approved tariffs for non-local authority customers will be implemented at the beginning of the application year and will remain in place for twelve months from the date of implementation.
- 8.4 The schedule of approved tariffs for Local Authority customers will be implemented three months into the application year, but will remain in place for twelve months from the date of implementation.

9 REVIEW AND MODIFICATION OF THE METHODOLOGY

- 9.1 NERSA will review the methodology as and when required to ensure that the contents of the methodology reflect the current regulatory circumstances. The Energy Regulator will continuously incorporate justifiable changes that are considered necessary to immediately capture clarity, transparency and regulatory efficiency benefits.

Stakeholders are requested to comment in writing on the Eskom Retail Tariff and Structural Adjustment Methodology Consultation Paper. Written comments can be forwarded to ertsa@nersa.org.za; hand-delivered to Kulawula House, 526 Madiba Street, Arcadia, Pretoria or posted to PO Box 40343, Arcadia, 0083, Pretoria, South Africa. The closing date for comments is 16 November 2015 at 16:00.

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