MYPD 6 Public Hearing

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19 November 2024

Framework

- *Agri Western Cape - background*
- *Importance of Electricity to the Agricultural Sector*
- *Arrear Municipal Debt*
- *Negotiated Price Agreements (NPAs)*
- *Stakeholder Questions*
- *Strategic Priorities*

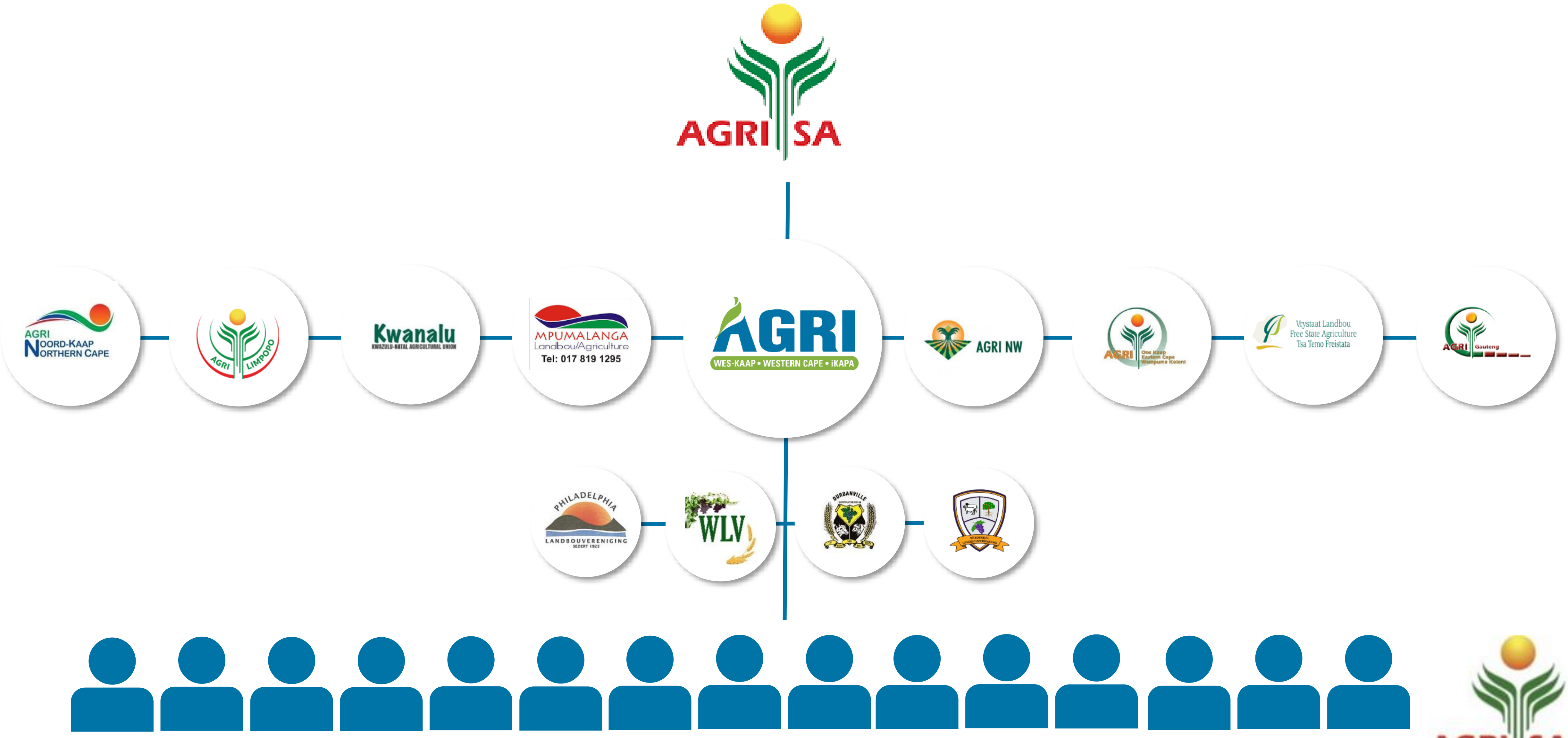
WHO IS AGRI WESTERN CAPE?

A-POLITICAL, FEDERAL, MEMBER ORGANISATION

Represents ±3 500 commercial farmers in the Western Cape:

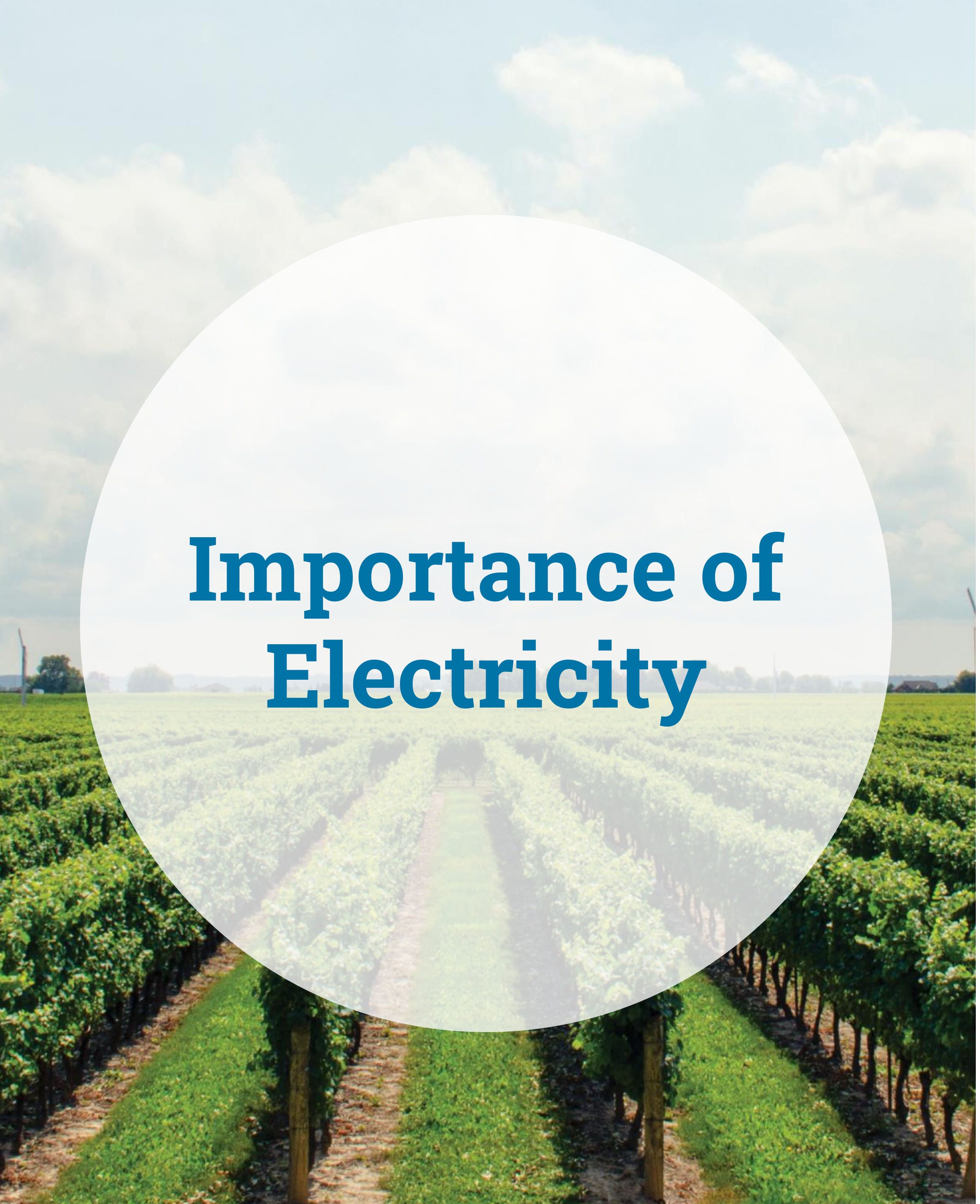
- **89** Agricultural Unions
- 14 District Agricultural Unions
- 22 Commodity Organisation
- Special Organisations

ORGANISED AGRICULTURE STRUCTURE



AGRI SA

Importance of Electricity to the Agri Sector



Importance of Electricity

Agricultural Electricity Use:

- Agri sector annual expenditure on electricity amounted to R10,4 bn in 2023/24
    - Western Cape related expenditure amounted to R2,6 bn (22,4%)
- 90% of Agri producers are dependent on Eskom as the primary or only source of electricity
- Irrigation and high-value crops
- Reliance on electricity throughout the food chain
- Prominent determinant of profitability
- Extremely low price-elasticity, indicating a captured market in the short term.

Arrear Municipal Debt

Electricity Demand By Municipalities (Arrear Debt)

- If municipalities were to pay their outstanding debt (± R80 billion), a relatively small tariff increase would be required for 2026. (Estimated 5% increase).

- The Free State and Gauteng are combined responsible for **more than 50% of debt owed to Eskom**. Within these provinces, the two largest municipalities are responsible for about 60% of the total Eskom debt of the province.

- No magic wand or "soft" option to deal with this matter amicable.

- The following, especially given the alleged failure of the Debt Relief initiative, should be considered:

    a) Replicating the model and related practices in the Western Cape given that this is the province with a negligible debt backlog.

    b) Reducing the share of municipalities (and maybe also provinces) conditional grants and equitable share of national income with an amount in proportion to their share in the debt owed to Eskom. AWC however, appreciates the fact that this could lead to constitutional ramifications.

Negotiated Price Agreements (NPAs)

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- For 2026, **further 10 NPAs were included**, resulting in almost **6 percentage points** of the requested tariff increase of 36,15% being attributable to this addition of NPAs.

- Given a backlog in tariff adjustment for 2025, **10 percentage points** attributable to NPAs are included in the current application according to Eskom.

- Data released by the International Energy Agency (IEA) indicate that Eskom's prices for industrial and domestic customers are **amongst the lowest** in the sample.

- If Eskom's **tariffs are competitive** on what basis is NPAs negotiated and agreed to?

- On face value, NPAs seem to place an **unreasonable burden** on electricity prices and consequently on other users of electricity.


Stakeholder
Questions

Commentary on Eskom's Application:

Eskom's revenue application translates into increases of:

- **FY2026 – 36,15%**
- FY2027 – 11,81%
- FY2028 – 9,10%

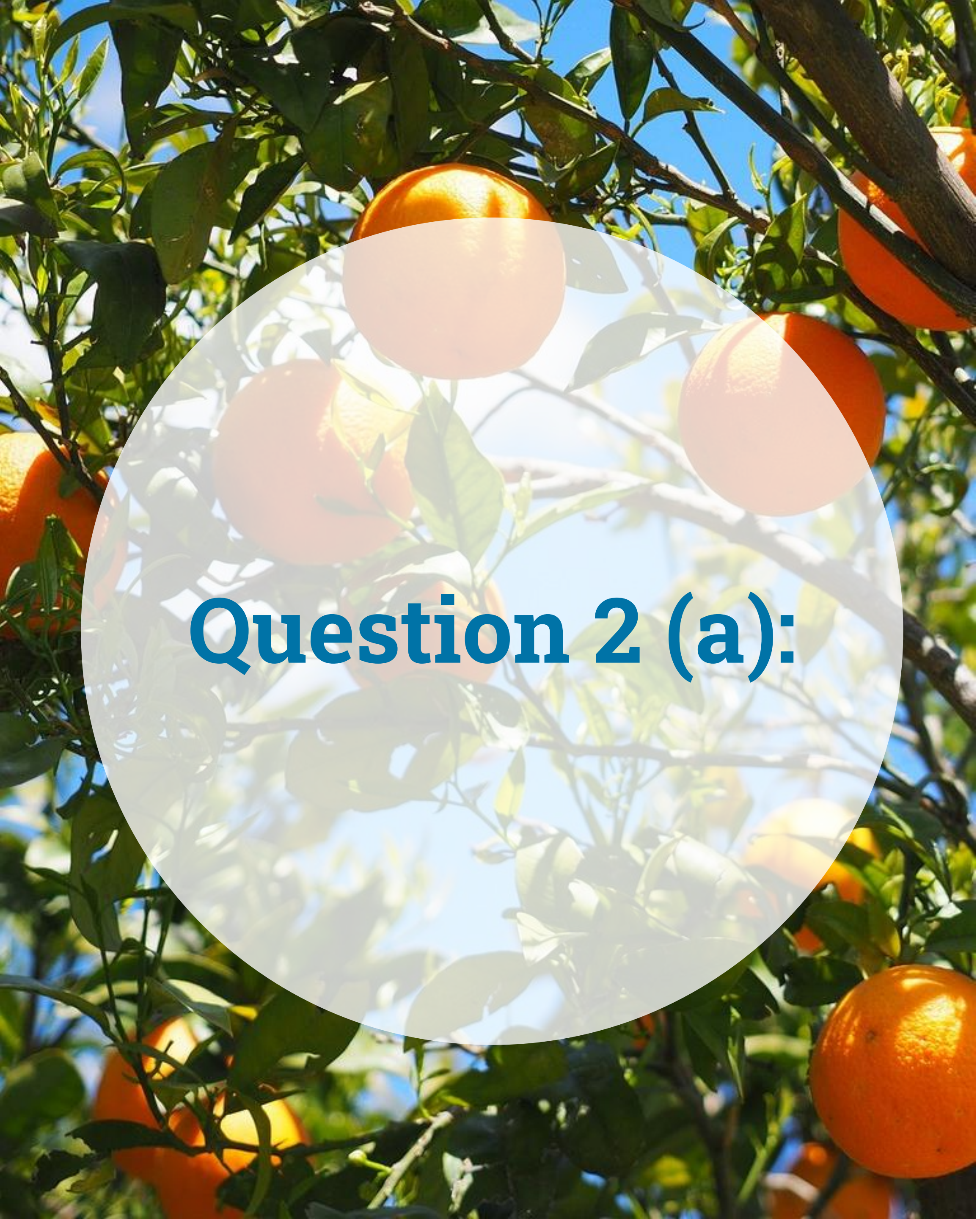
Derived from increased:

- Return on Assets = R27 billion (29%)
- Primary energy = R35 billion (37%)
- Operating costs = R32 billion (35%).

Plus:
- Environmental Levy = R6,5 bn
- Carbon tax = R5,5 bn

Commentary on Eskom's Application:

- Reductions in the major cost drivers necessary to reduce requested income to more moderate levels.
- Other aspects like municipal debt, NPAs and corruption should also be addressed.
- AWC agrees that tariff increases should at least be sufficient to transition Eskom towards a more cost-reflective electricity tariff (prudently and efficiently incurred).
- Unfortunately, there currently prevails scepticism as to whether prudence and efficiency are adhered to. The observed disconnect between NERSA and Eskom partly testifies to this.
- A critical factor in this regard is the prudency of contracts. The MYPD methodology requires the Energy Regulator to review the efficiency of all contracts, before the conclusion of the contracts, to ensure prudency. Whether this is consistently done is unlikely. AWC stands to be corrected.



Question 2 (a):

Commentary on the treatment of costs:

i. Coal costs
ii. Operating costs
iii. Regulatory Assets base
iv. Sales forecasting

Question 2 (i) – Treatment of Coal Costs

- Primary Energy Costs - **Largest contributor** to requested revenue increase.
- Coal remains the **dominant primary energy cost** - almost 70% of total primary energy cost

Coal demand in line with relatively low EAF?

- Coal **prices** and **availability** are key in determining the costs of generation

Detailed **audits** of coal supply chain & contracts

- Approximately 64% of the SA coal market is dominated by **5 players**.

Contract oversight to avoid anti-competitive pricing practices

- Coal **procurement challenges** include:
  - Eskom supplier base limited.
  - Mines targeting export markets.
  - No new Greenfield investments in mining.
  - Middling coal exported to India and China.

Temporary Export duties

Question 2 (ii) – Treatment of Operating Costs

- NERSA's decision for 2025 amounted to **R62 billion**.
- Eskom's application for 2026 amounts to **R93 billion**

Drastic increase from Nersa's base decision (almost 50%)

- Eskom accuses NERSA of not having provided any analysis for its previous decisions (p101).
- Vast differences in calculations between NERSA and Eskom are difficult to understand.
- AWC finds it difficult to comment on operating costs given the disparity of the calculations presented.

More understandable exposition should be disclosed.

Continued…

Question 2 (ii) – Treatment of Operating Costs

Workforce cost

- Specific benchmarking is required to determine if workforce cost is efficient.

- Eskom indicate that:
    - Salaries at lower level of business are above market median;
    - Managerial level are aligned with market

- Workforce cost per employment level should be scrutinized by NERSA.

Maintenance Cost

- Eskom is in a peculiar position:
    - Over half of power stations older than 40y
    - Those supposed to be decommissioned are bought back into operation
    - No new power stations planned

- Existing capacity needs to be run harder -> greater need for maintenance

Question 2 (iii) – Treatment of Regulatory Asset Base

- Depreciated replacement cost assets constitute the bulk of the RAB and will decrease substantially over the particular period.

- Value of assets was determined in **March 2020**

- In 2024, more than R500 billion was added to the opening balance as a valuation adjustment doubling the value of RAB

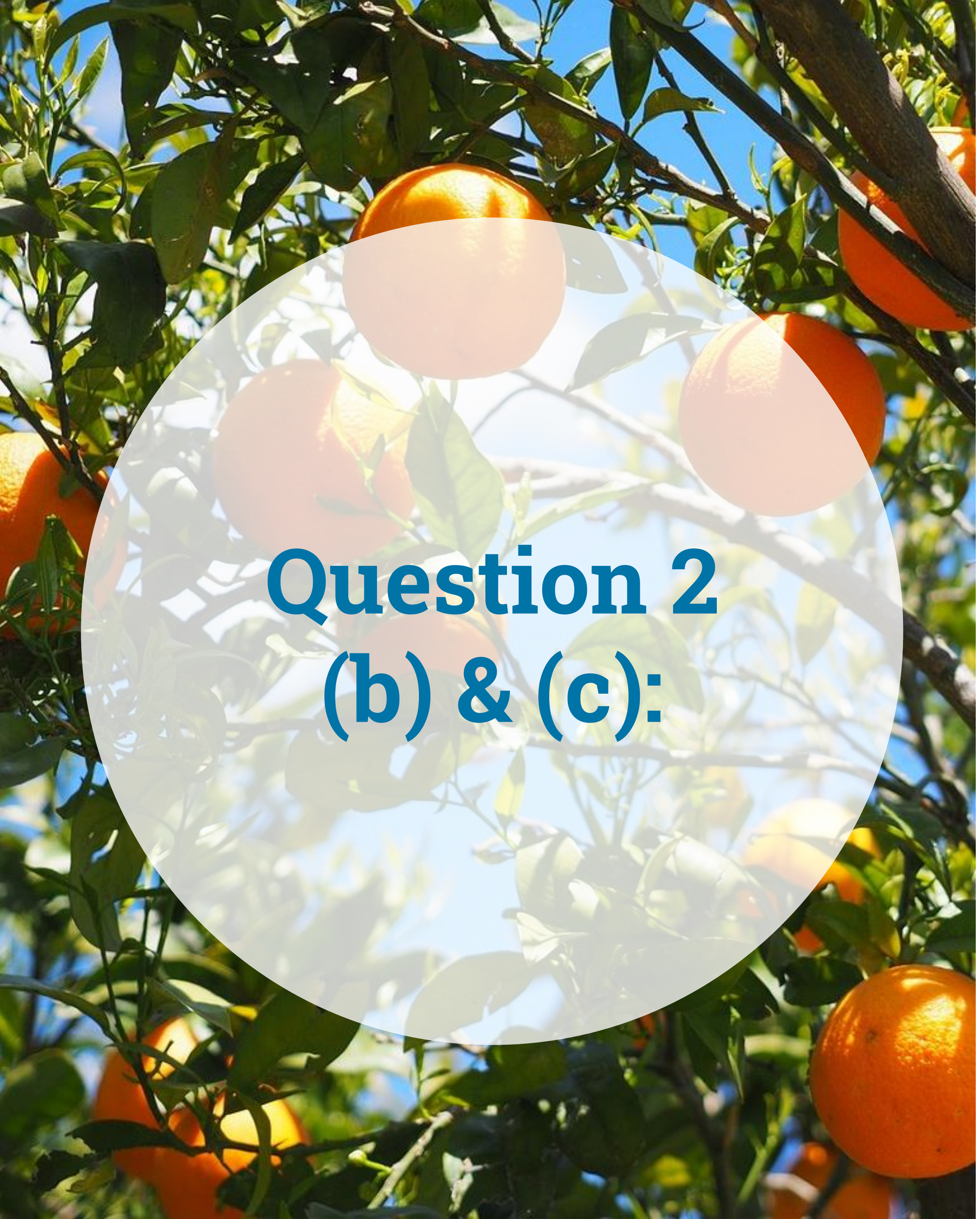
- NERSA should probably **revisit these figures** with respect to:

  - Seriously inflated new generating facilities
    - *Replacement costs could be much lower.*

  - At least some of the existing infrastructure (plants) is **unlikely to be replaced**, implying that historical costs might be a better basis for valuation.

Question 2 (iv) – Sales Forecasting

- According to Eskom, sales since 2006 have declined by an estimated average of 0,5% per year.
- Declines of 1,8% and 1,3% are expected for 2026 and 2027.
- Under these circumstances, one could at least expect that **variable costs** should decrease accordingly.
- Due to various factors (e.g. service-oriented economy), the economy at large is expected to become **less energy intensive**.
- If a 36,15% tariff increase materialise, **a response in demand** will be seen regardless of the relative price inelasticity of electricity demand.
- Would be detrimental to **Eskom's revenue** (if existing inefficiencies cannot be overcome).



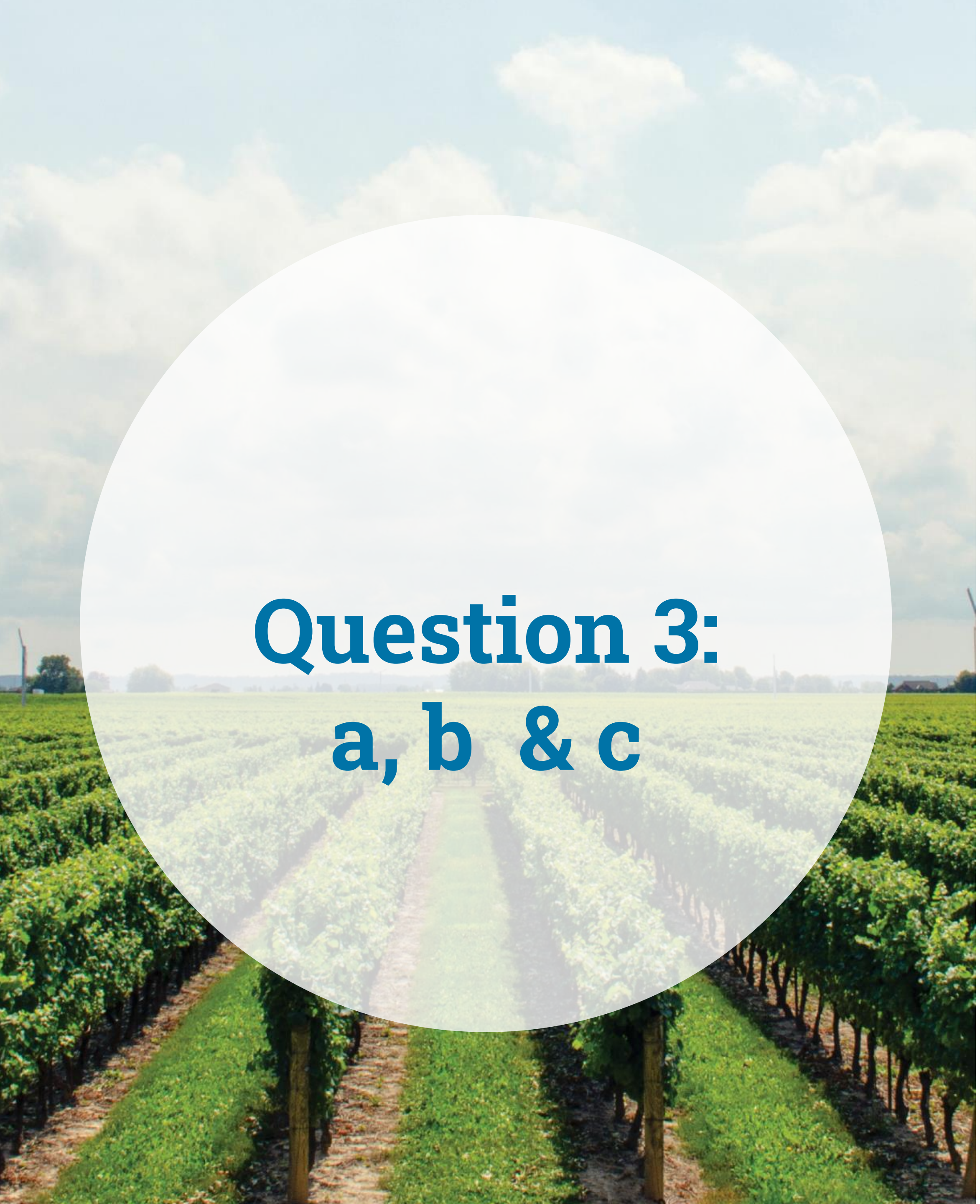
Question 2 (b) & (c):

2 (b) Utilisation of Eskom's fleet:

- Eskom indicates that up to 2030 no power stations will be de-commissioned.
- Eskom's application included this expectation in their calculations if Agri Western Cape understood it correctly.

2 (c) NERSA discretion in this regard

- Whether NERSA will be in a position to exercise any discretion in this regard is unlikely as Eskom deemed it necessary for optimum supply of electricity.



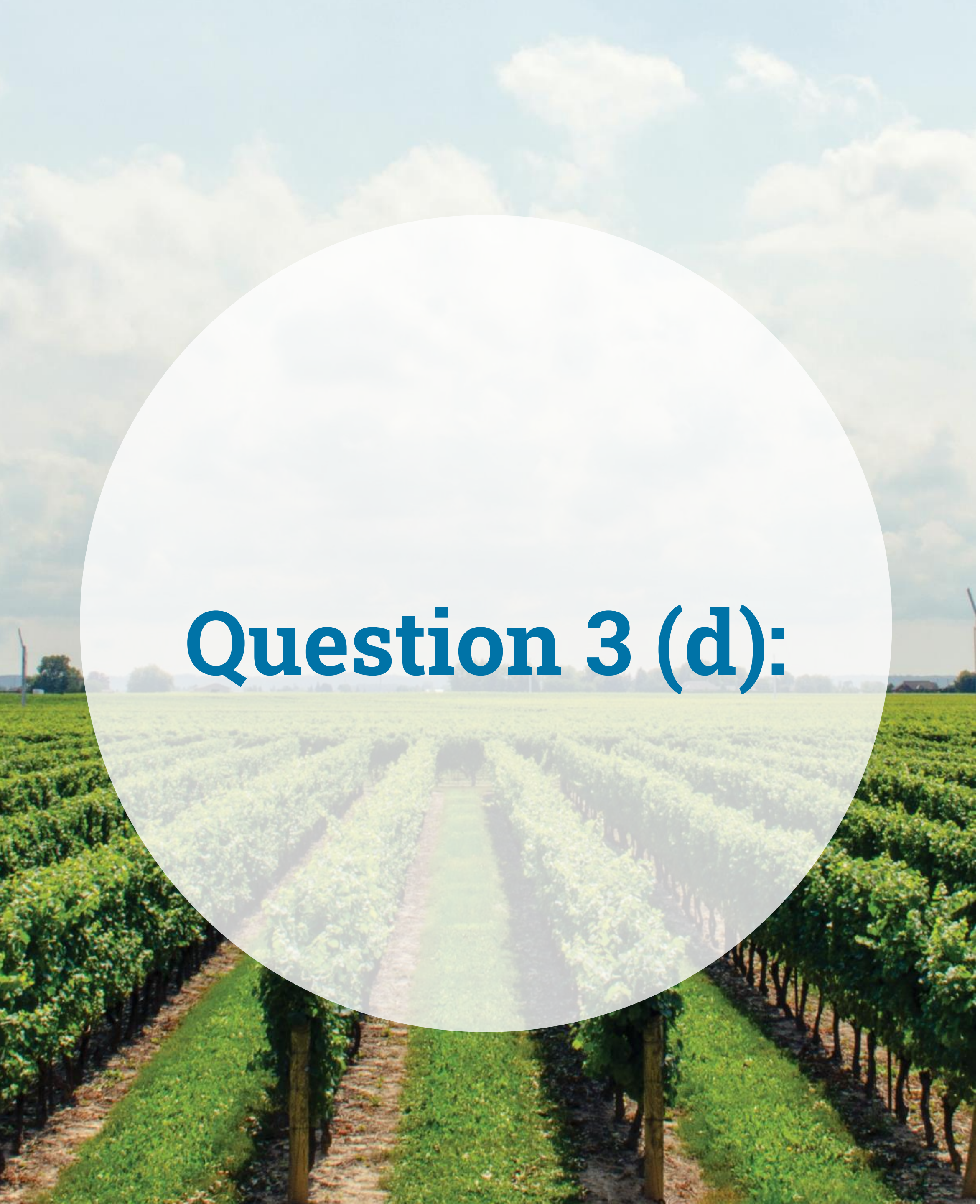
NTCA, generation and distribution:

- Whether separate revenue determination for NTCA, generation and distribution can be done in the **short term** is unlikely.

- That it should be done in the **future** is advisable:

  a) More clearly delineated:
     - Operating costs,
     - Asset lifespans,
     - Cost of capital

  b) Inefficiencies probably earlier identified
  c) Extent of cross-subsidisation internally made clearer.



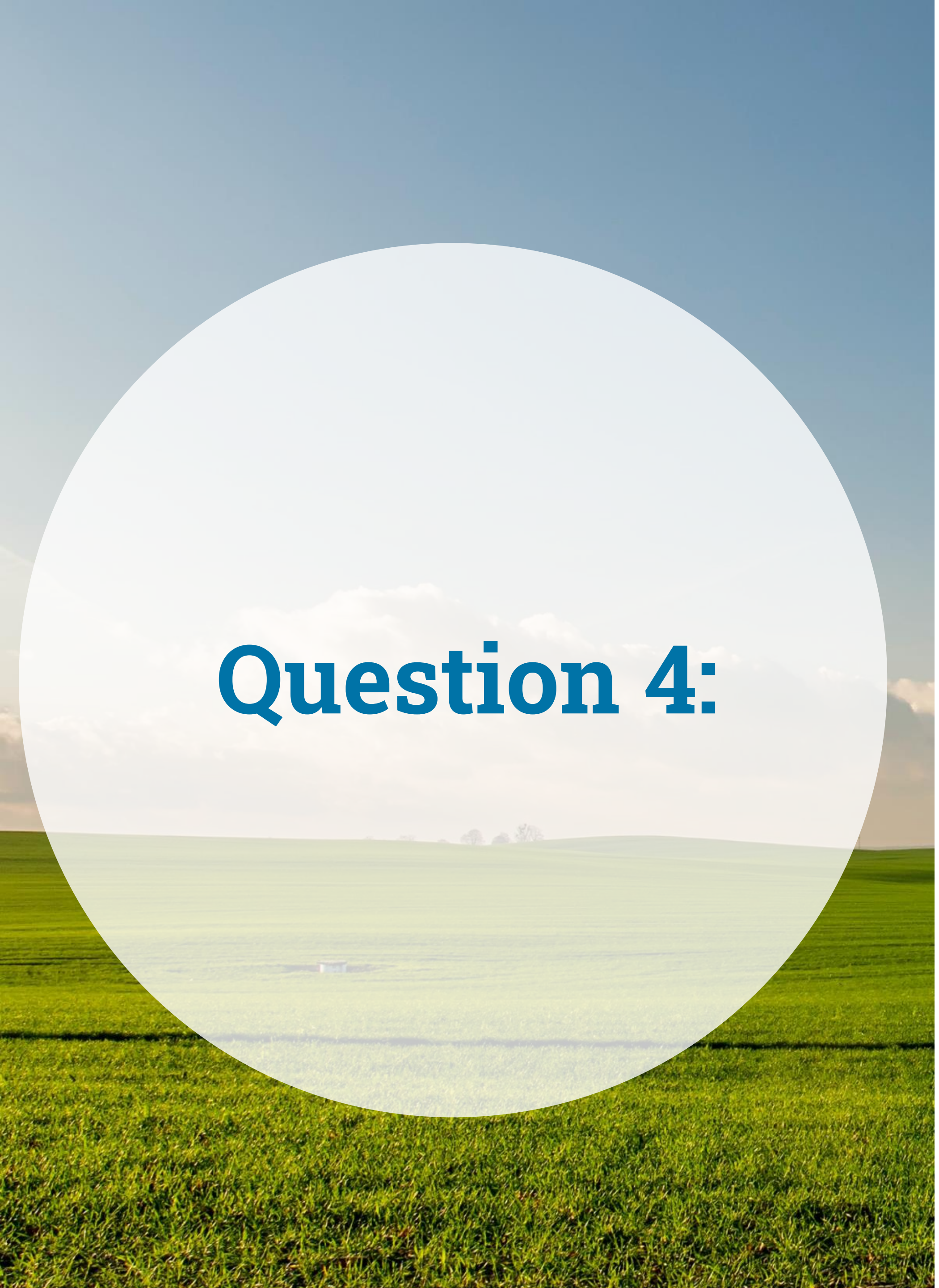
3 (d) – Imprudence/inefficiency of Eskom

- Alluded to contract oversight, fraud, and corruption recovery in our submission.

- Remediate actions are the **responsibility of NERSA** and the line departments within the government.

- In terms of the ERA:

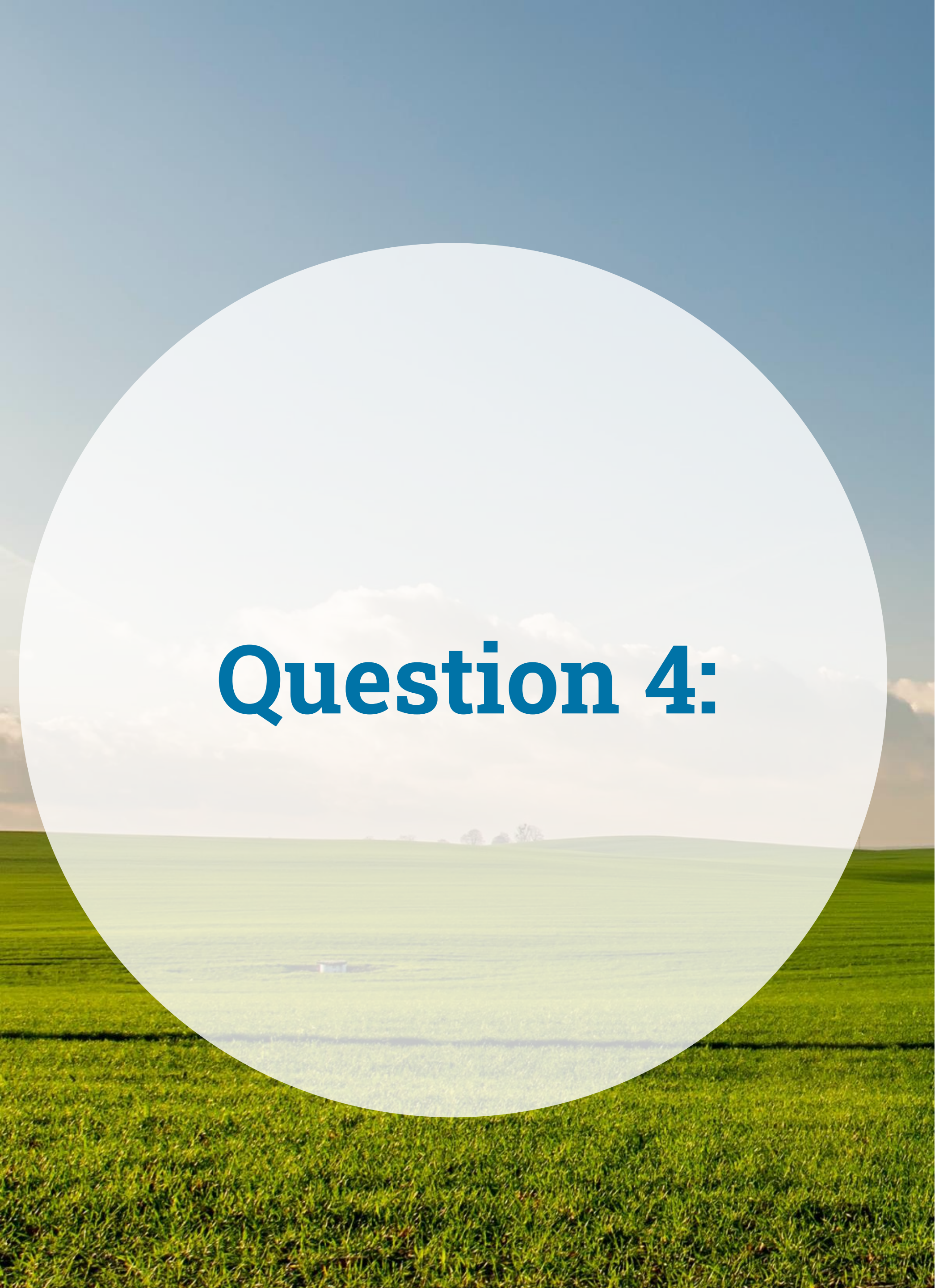
*“the Regulator must **enforce performance** and **compliance** and take **appropriate steps** in the case of non-performance”.*



Question 4:

4 (a) – Does NERSA have the mandate to process a revenue application?

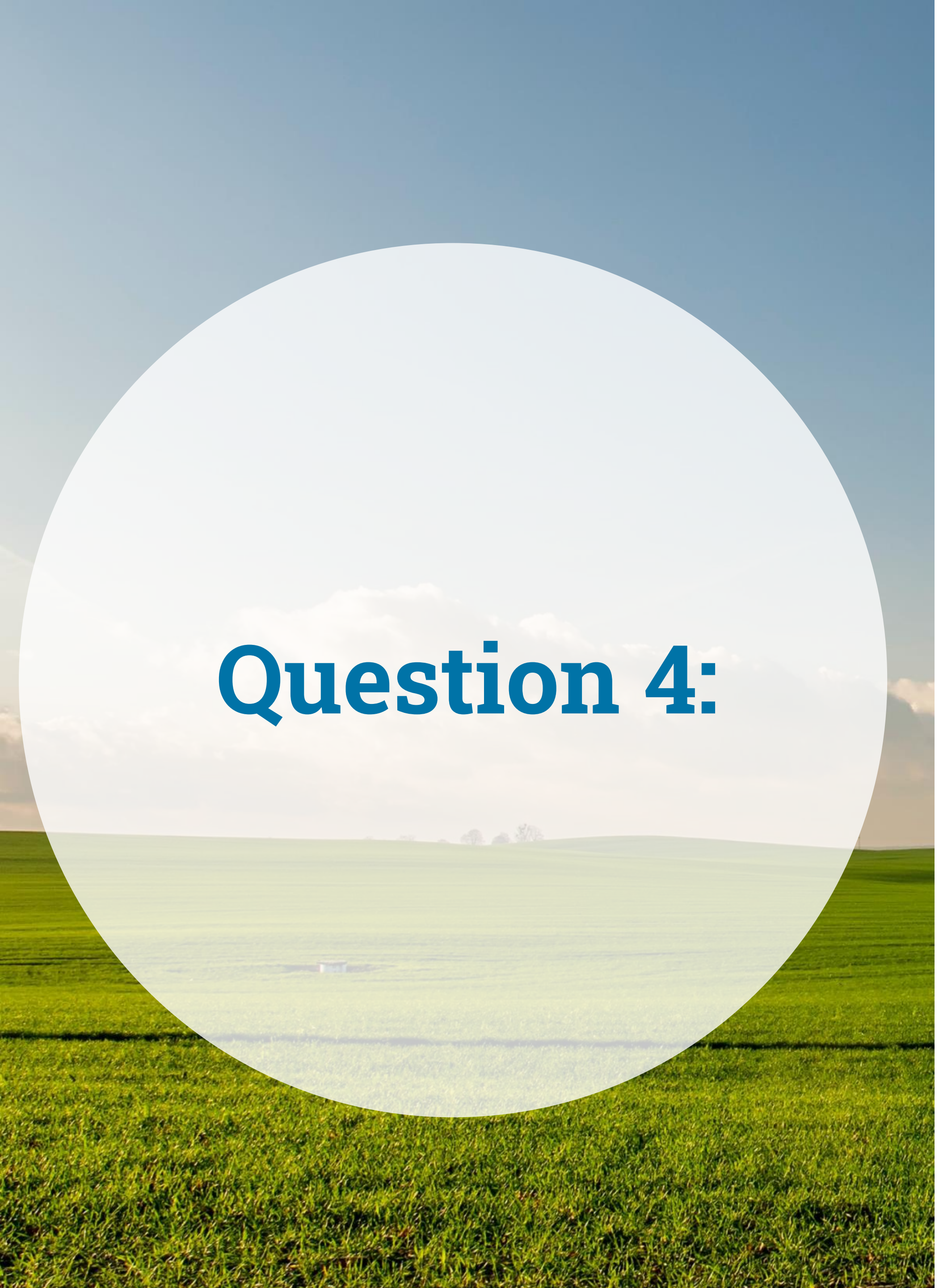
- Seeing that NERSA has to also deal with Revenue Clearing Accounts (RCAs) it probably has the mandate to process a revenue application.



Question 4:

4 (b) – Is it proper for NERSA to deal with MYPD6 in the format it is given?

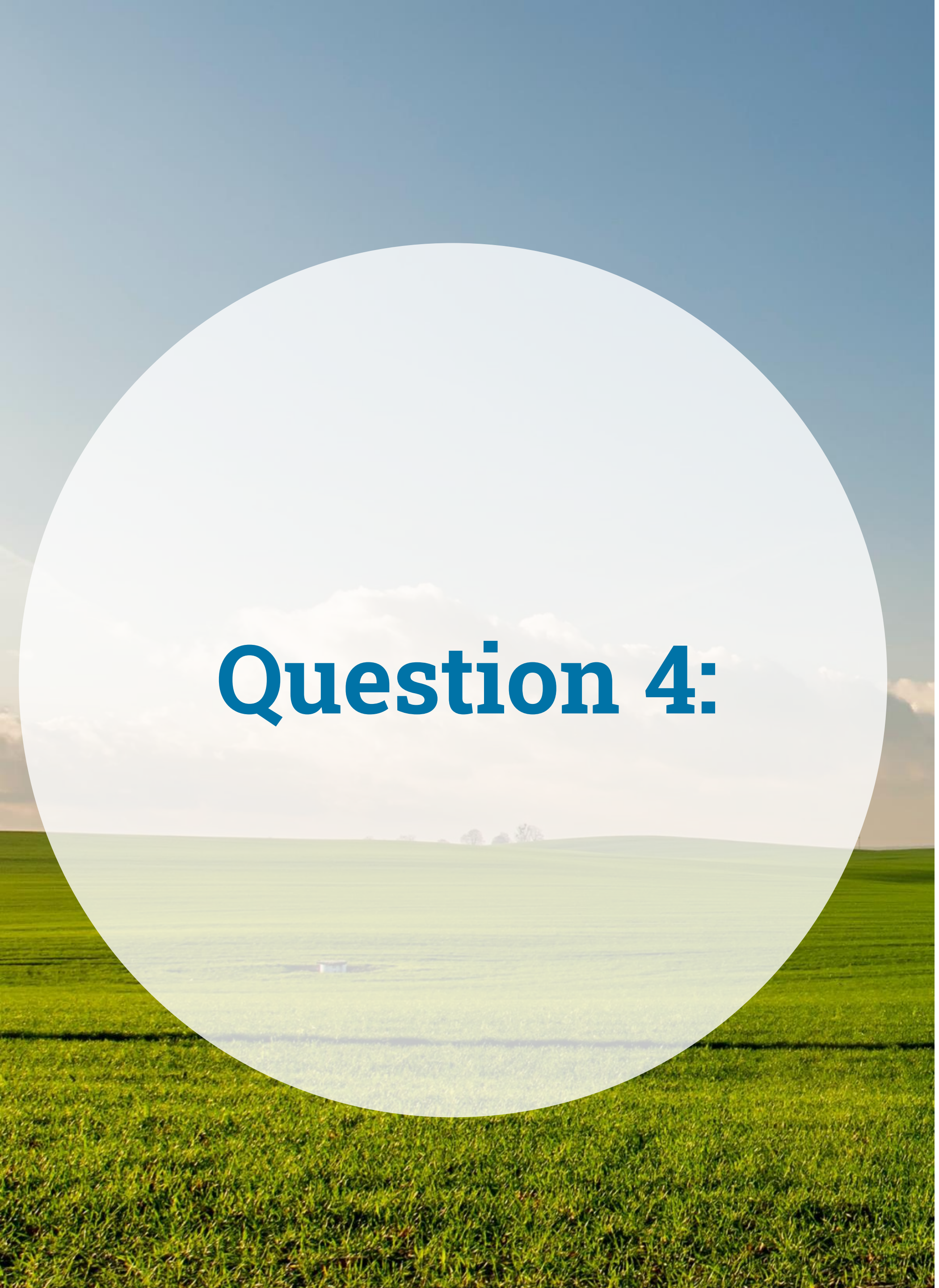
- Yes, NERSA will have to deal with Eskom's application during the transitioning phase.



4 (c) – How should NERSA determine NTCSA revenues and corresponding tariff?

- As a **separate cost-center** as previously indicated.

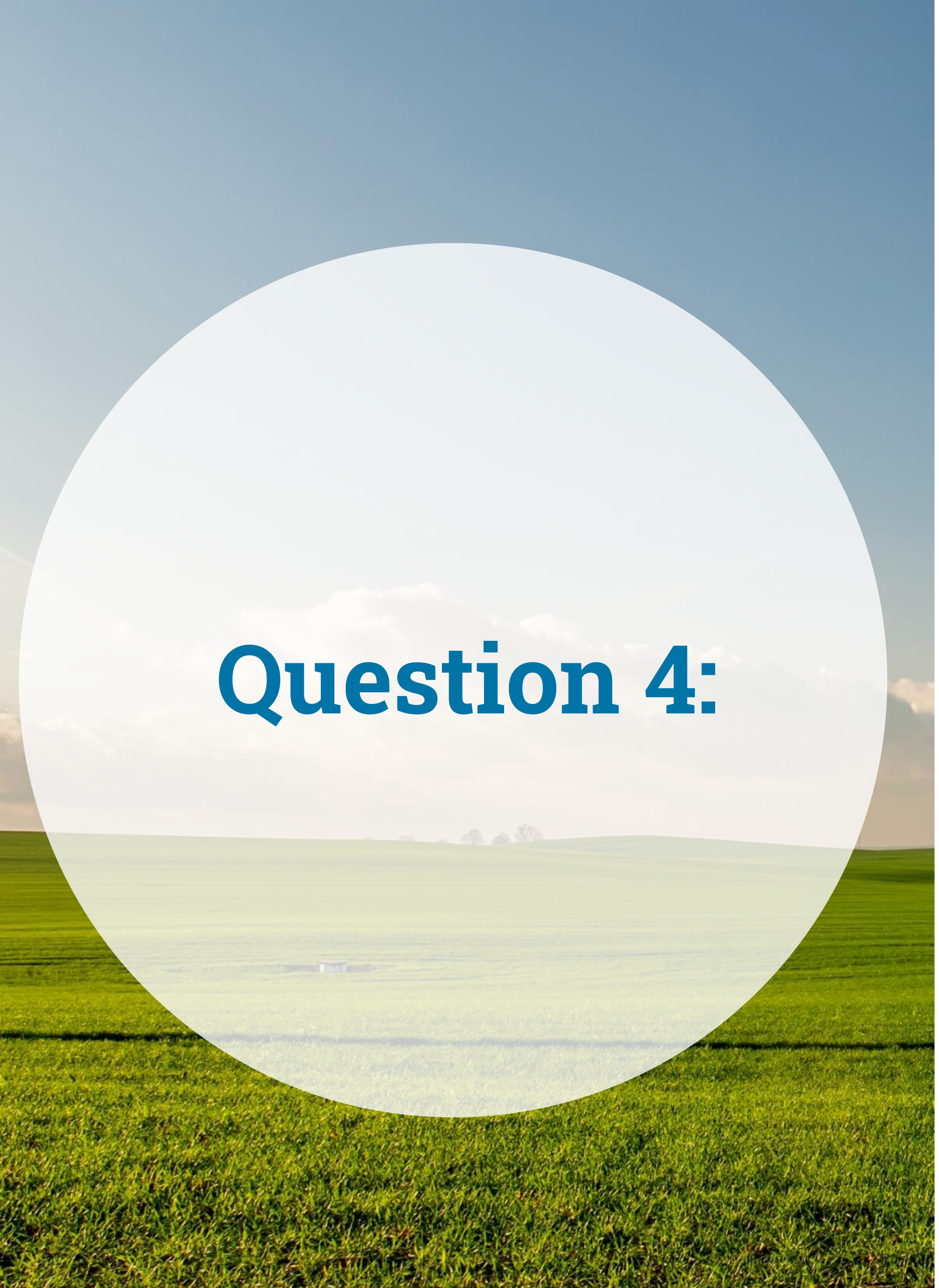
- It needs to be noted that as a wholly owned subsidiary, Eskom will still control operations, policies and management.



Question 4:

4 (d) – Comments of the same WACC percentage applied for all business activities

- WACC can most likely not be practically disaggregated until separation of business units has occurred



Question 4:

4 (e) – Comments on Eskom's assertion that NERSA continues to limit Eskom's tariff increases below cost-reflective levels

- Given the vast difference in operational costs, Eskom's assertion might contain an element of truth.
- Eskom mention that NERSA simply applies some form of indexing (CPI or PPI) to arrive at certain outcomes.
- Clear disconnect between NERSA and Eskom on a matter so vastly important to the country and our sector.

Question 5:

5 (a) – Use of MYPD4 methodology in MYPD6 application

- Eskom probably had no choice given that the legal basis for MYPD methodology is in ERA

5 (b) – Regulatory Framework

- Prudent costs to be recovered are in line with MYPD methodology and the applicable legislative framework.

- The question remains:

Are costs **prudently incurred** and how and when is NERSA's discretion factored into the particular analysis?

Conclusion & Recommendations

Conclusion

AWC concurs with the content of the MYPD, inter alia calling for consideration of the best interest of

1. Eskom;
2. South African Economy;
3. Public.

However, the requested increase will not serve the interest of all the parties

Given the current use of electricity in the agri sector, many producers won't be able to afford a cost increase of this magnitude.

Recommendations

With a view to **reduce the drastic tariff increase** proposed by Eskom, our submission recommends the following...

Recommendations:

1. NERSA to revisit and consider recommendations of the **VGBE report**, commissioned by National Treasury, that was released on 1 March 2024.
2. More stringent measures to **collect outstanding debt** from municipalities.
3. Reducing the requested level for **return on assets (ROA)** to more manageable levels.
4. Temporary **forfeiture** of the **environmental levy** and **carbon tax** by the fiscus.
5. Revisiting **negotiated price agreements**, especially with respect to subsidy levels.
6. Greater involvement of NERSA with the **oversight of Eskom contracts**.
7. Speeding up of processes to deal with **fraud and corruption** and to recover funds.
8. Disclosing more information on the **disconnect between NERSA and Eskom** especially with respect to operating costs.
9. Possibility of **export duties** on coal exports be investigated.
10. Limited further **financial support** by government to be turned into **equity** in future.
11. Consideration of the **economic impact** of an increase of 36,15% in electricity tariffs on the economy (i.e. increase in inflation and interest rates).

Thank you!