Energy Intensive Users Group of
Southern Africa NPC
Reg no: 2019/478422/08
Address: Building 4, Summit Place Office Park,
221 Garsfontein Road, Pretoria, 0081
Email: info@eiug.org.za | Web: www.eiug.org.za

30 June 2021

MR NHLANHLA GUMEDE

Energy Regulator

National Energy Regulator of South Africa (NERSA)
PO Box 40343
Arcadia
0083
PRETORIA
Email: mypd@nersa.org.za <mypd@nersa.org.za>

Dear Mr Gumede

EIUG RESPONSE: PUBLIC CONSULTATION ON THE ESKOM FY20 RCA

The Energy Intensive Users Group of Southern Africa ("EIUG") was established in 1999 as a voluntary, non-profit association. It was incorporated as a Non-Profit Company in 2019. The group was founded on the belief that energy is the engine for economic growth and development in the country.

The EIUG represents intensive energy users consuming around 40% of electricity, contributing over 20% of GDP and employing over 650 000 employees. EIUG therefore has a skin in the game and appreciates the opportunity to be heard in ESI related deliberations. The EIUG continues to engage Eskom, NERSA, government departments and other stakeholders in a constructive manner to raise our concerns and work with them in finding solutions. As a collective of stakeholders, we need to create an enabling electricity supply industry in order to prosper and empower the country through the deployment of self-generation, closing of the national supply deficit, stabilising our escalating electricity costs and the decarbonisation of our economy. The success of our economy is heavily dependent on a reliable and affordable electricity supply industry.

The EIUG therefore welcomes the opportunity to contribute to this important consultation in the determination process for Eskom's fourth Multi-Year Price Determination (MYPD4) Regulatory Clearing Account (RCA) Year 1 (2019/20) application. To this effect EIUG will

comment only to a few aspects of the balances being applied for but focus more on some of the issues which repeatedly results in the volatility of the prices be it through RCA or recent court reviews. In essence we believe the key issues to this application relate to

i) The poor maintenance regime applied by Eskom;
ii) The unsuitability of the pricing methodology or alternatively its implementation challenges; and
iii) The absence of a forward-looking price path in getting to cost reflective tariffs.

Attached please find our response as annexure to this letter.

Yours sincerely

FANELE MONDI
Chief Executive Officer
+27 76 823 7086
Fanele.Mondi@eiug.org.za

ANNEXURE A:

EIUG RESPONSE: PUBLIC CONSULTATION ON THE ESKOM FY20 RCA

RCA Balance Application Considerations:

The Eskom application is for an RCA balance of R8.42bn for the Financial Year 2019/20 (FY20). The amounts are consolidated on the Eskom application as follows:

Table 1: Summary of 2020 RCA Application

RCA for FY2020	Decision FY2020	Actuals FY2020	Variance	RCA Adjustments	RCA FY2020
Regulated Assets Base (RAB)	931 043	904 361	(26 682)		(26 682)
Return on Assets (ROA)	1,5%	1,5%	-		-
Return (Adjusted for government assistance)	(8 752)	(9 192)	(439)	-	(439)
Expenditure	51 267	62 229	10 962	(11 172)	(211)
Primary Energy	67 090	72 113	5 023	(65)	4 957
Independent Power Producers (local)	30 462	29 693	(769)	385	(384)
International purchases	3 059	4 704	1 645	-	1 645
Depreciation	55 867	52 884	(2 983)	-	(2 983)
Research & Development	136	89	(47)	-	(47)
Levies & taxes	7 443	7 613	170	-	170
Revenue	206 572	199 468	7 104	(1 475)	5 629
Service Quality Incentives (SQI)	-	-	-	-	-
FY 2020 RCA Balance due to Eskom					**8 337**
Nuclear decommissioning from RCA 2013/14 decision liquidated over 10 years - (7th year of 10 years)					83
Total RCA balance					**8 420**

Note:

a) The *costs variance* is calculated as *Actual* minus *Decision*

b) *Revenue variance* is calculated as *Decision* minus *Actual*

Eskom goes at length into explaining the legislative requirements, regulatory rules and court orders justifying the claw-back and all that information is useful in considering this application. However, Eskom did not in some of the cases take accountability for their own shortcomings in the amounts being claimed, Eskom just referred to them as matters beyond Eskom control, aging fleet or that they were because of government not making decisions about the new-build in the ninety's. It is felt that while such may have been a good reason in the mid 2000's, surely it cannot still be the reason in 2020. The table below shows how the generation performance (UCLF and EAF), sales (MWh) and peak demand (MW) have deteriorated over the last 10 years while both Eskom and IPP nominal capacity (MW) and

revenue (R'bn) increased substantially for the same period. The table also shows how the maintenance (PCLF) has been hovering around 10% for the same period with only two years where it increased with a positive EAF impact on the years that follow. It is therefore clear that the current challenges Eskom is facing are that of maintenance than the decision on capacity that was made late. Also, important to note is that even for the RCA year (FY20), Eskom underperformed on maintenance, where the target was 9.5% versus actuals of 8.9% and again this is attributed to factors beyond Eskom control.

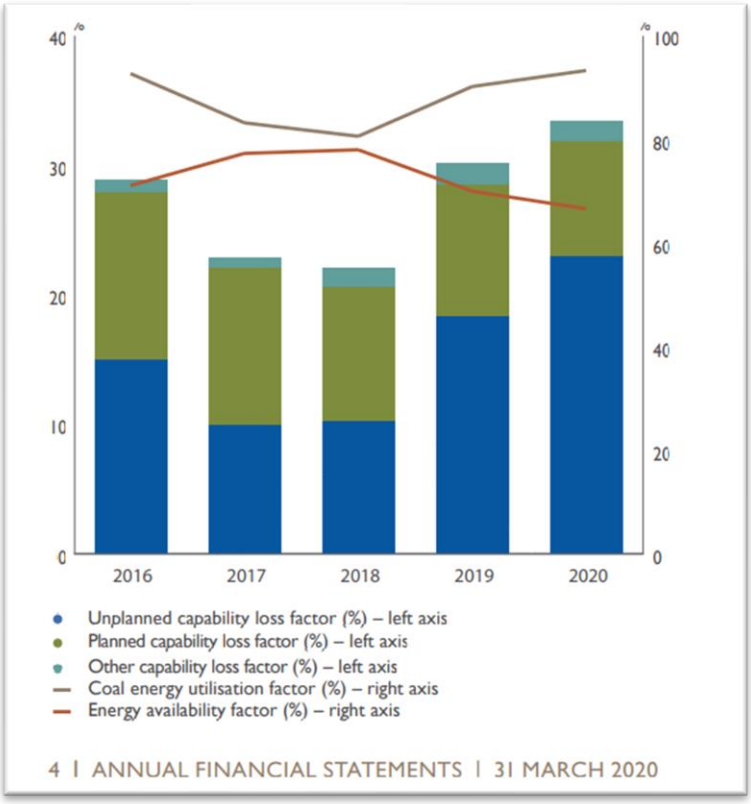
Table2: Technical Statistic FY11-FY20

	FY2020	FY2019	FY2018	FY2017	FY2016	FY2015	FY2014	FY2013	FY2012	FY2011
Revenue (Rm)	197 307	177 312	174 905	175 094	161 688	146 268	136 869	126 663	112 999	90 375
Sales (GWh)	205 635	208 319	212 190	214 121	214 487	216 274	217 903	216 561	224 785	224 446
Peak Demand (MW)	32 948	34 256	35 301	34 122	33 345	34 768	34 977	35 525	36 212	36 664
EAF	66.64	69.95	78.00	77.30	71.07	73.73	75.13	77.65	81.99	84.59
UCLF (%)	22.86	18.31	10.18	9.90	14.91	15.22	12.61	12.12	7.97	6.14
PCLF (%)	8.92	10.1	10.35	12.14	12.99	9.91	10.50	9.10	9.07	7.98
Nominal Eskom Capacity (MW)	45 117	44 172	45 561	44 134	42 810	42 090	41 995	41 919	41 647	41 194
Nominal IPP Capacity (MW)	5 206	4 981	4 779	5 027	3 392	2 606	1 677	1 135	1 008	803

Data Source: FY20 Eskom Integrated Report; page 140 & 141

It is the view of the EIUG that maintenance is normally in the control of management, but we also acknowledge that at some point when the nominal capacity was low resulting in unsustainable net reserve margins and the demand was high, there may have been cases where there was no opportunity to do maintenance. It is also acknowledged that the shareholder may have asserted pressure on Eskom by insisting on keeping the lights on but this as Eskom indicated in the application was discontinued as early as April 2013.

In some instances, Eskom indicated that the poor performance is as a result of running the plant at high utilization factors which then result in more plant breakdowns. To this effect Eskom produced graphs justifying this argument. However, a closer look especially at the recent graphs does not seem to prove the causality being claimed using the logic that the plant will fail after being operated harder. Using this logic, one would expect the UCLF curve to follow the EUF curve but that does not seem to be the case as demonstrated below, as shown in Eskom FY20 AFS (page 4):



The EUF seems to respond to unavailability of plant, that is, as more plants are unavailable the remaining plants get to run harder and hence high utilization factor.

It is for these reasons that the EIUG is of the view that Eskom has to take responsibility for the current poor performance in terms of plant reliability and low energy availability that resulted in Eskom augmenting supply with expensive alternative options. Where factors beyond Eskom's control are identified, only then should such matters be considered valid for RCA applications. In such case Eskom will still have to prove that such costs were efficiently and prudently incurred. To also note is that in the Eskom Integrated Report (page 86), Eskom admits that "Undeniably, our operating performance over the past year was largely disappointing. Nevertheless, we keep working on addressing the challenges identified."

However, in this application Eskom seems to shift this poor performance to the consumers while Eskom is addressing the challenges. The MYPD4 Methodology allows NERSA to "to appropriately allocate commercial risk between Eskom and its customers". The following is therefore the costs which EIUG believes should either be completely declined or at best be significantly reduced in order to appropriately allocate risks:

Table 3: FY20 Fuel Oil Usage (Rm)

MYPD4 Application (MA)	NERSA Decision (ND)	Actual (A)	Variance (A-MA)	Variance (A-ND)
1 893	1 751	3 960	2 067	**2 209**

The NERSA decision (R1 751m) was marginally lower than Eskom applied for (R1 893m). Eskom seems to have lost control of the fuel oil usage even against both application plan and NERSA Decision. Reasons given are that there were more trips and more shutdowns for planned and unplanned maintenance. On the year (FY19) in which Eskom submitted the application, trips were 517 compared to 595 trips (FY20) and UCLF was 18.31% (FY19) compared 22.86% (FY20). Eskom should have had a good estimate for costs projection for a year ahead to miss the target by more than 100%, it is difficult to accept such as being efficient and prudent, and hence this claim (R2 209m) should be declined or substantially reduced to appropriately allocate risks between Eskom and consumers.

Table 4: FY20 OCGT Diesel Usage (Rm)

MYPD4 Application (MA)	NERSA Decision (ND)	Actual (A)	Variance (A-MA)	Variance (A-ND)
6 975	1 902	4 303	-2 672	**2 401**

Even though NERSA decision was substantially lower than the Eskom application, the message was clear that Eskom cannot continue to use OCGT's at these high load factors. Eskom continued to use the diesel to supplement poor plant performance and hence this huge variance which is now expected to be borne by consumers. Poor plant performance as indicated earlier is a result of poor maintenance which by and large is in the control of management and hence this claim (R2 401m) should be declined or substantially reduced to appropriately allocate risks between Eskom and consumers.

Another matter for consideration is the application of MYPD4 methodology. In the application Eskom implies that since this application is within 4% of the allowable revenue then it should

be liquidated in the following financial year (i.e. FY23). Whether this is the correct application of the rule or not what may also need to be considered is that in fact this application is actually just above 4% and strictly speaking the rule is that "If the (RCA) balance is greater than 4% of the allowable revenue, Eskom must make a completely new application for a new MYPD determination." Admittedly, the application amount is only marginally above 4%, whether that is material or not, NERSA will have to apply its mind.

Other Considerations for NERSA

Liquidation Period: In the light of the MYPD4 Methodology objectives "to ensure Eskom's sustainability as a business and limit the risk of excess or inadequate returns while providing incentives for new investment;" and "to provide a systematic basis for revenue/tariff setting;" NERSA is respectfully reminded to consider these objectives when considering the liquidation period. This is especially so considering the compounding net effect of the court orders, other RCAs and the coming MYPD 5 application which will all apply in FY23.

Price Path: The EIUG concurs with Eskom on a need "… for NERSA to annually provide a 10-year electricity price path in South Africa." This price path will assist Eskom and consumers in planning their operations and investments as well as hopefully in bringing a sustainable price path that will assist Eskom in being sustainable while at the same time taking into cognisance the socio-economic impacts of consumers in line with the MYPD Methodology objectives. It is imperative that NERSA expedite initiating such a process.

Impact of Court Orders: While recognising the rights of NERSA and Eskom in fulfilling their respective mandates and the need for courts as final arbiters, it is important that all parties take the necessary steps in reviewing the applications so that the litigation route is kept to the bare minimum. The impact of litigation is that it takes a longer time to resolve, and the outcomes inevitably affect consumers which in the recent cases all had been negative to the consumer. The net effect is the volatility and uncertainty of prices for consumers.

MYPD Methodology Review: The EIUG is of the view that this methodology is not delivering on almost all its objectives as listed below and especially that of price certainty.

The objectives are:

a) to ensure Eskom's sustainability as a business and limit the risk of excess or inadequate returns while providing incentives for new investment;

b) to ensure reasonable tariff stability and smoothed changes over time consistent with socio-economic objectives of the Government;

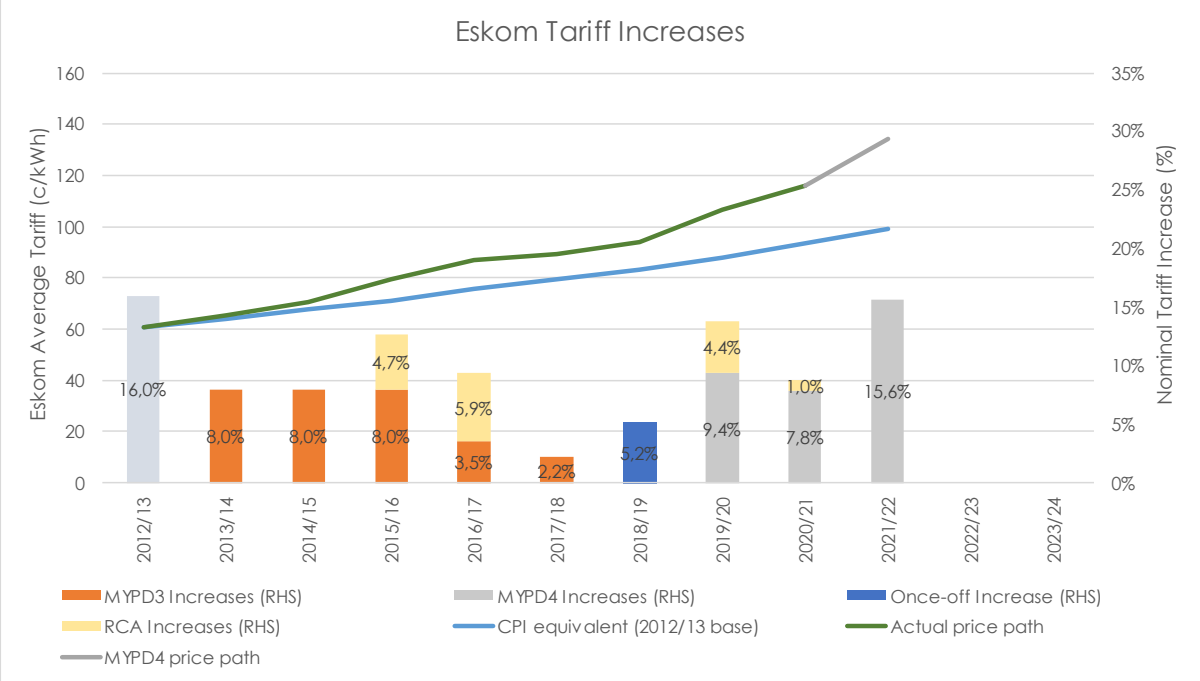
c) to appropriately allocate commercial risk between Eskom and its customers;

d) to provide efficiency incentives without leading to unintended consequences of regulation on performance;

e) to provide a systematic basis for revenue/tariff setting; and

f) to ensure consistency between price control periods

Notwithstanding that we are soon moving to MYPD5, we have thus already had four attempts in delivering on the stated objectives, with the reality being that they have not been achieved. The review will need to consider whether the methodology is correct and fits the South African context or if, as a country, we have failed to implement the methodology to the benefit of any of the stakeholders. Just looking at the price certainty, one can easily observe the price volatility that has been experienced over the years:



Factoring in the pending court orders, outstanding RCAs and MYPD 5 on this graph will show even more volatility of prices. It is for these reasons that EIUG, while acknowledging the 2016 review of the methodology, believes there is a need to fundamentally review not

only what can be improved but the suitability of the methodology and/or how best to implement the methodology if it is still considered the preferred methodology to achieve the stated desired objectives. Also, to be factored in are the implications of a fast-changing Electricity Supply Industry with alternative generation options (IPP's and Self-Generation) and unbundling of Eskom.

Considering that MYPD 5 is due soon, certainly before which any meaningful review could be done, which then coupled to a call for a 10-year price path; it is imperative that the next tariff determination be viewed as an interim increase while the Regulator, Eskom and stakeholders work out what best suits established objectives for future increases.

In conclusion, the EIUG is alarmed at the deterioration of the industrial and mining sectors in South Africa in part due to unaffordable electricity prices. This is evidenced by the steady decline in Eskom's energy supplied, which last year (2020) was almost 21% below 2008 levels, and the number of industrial and mining customers dropped by 11%. This is due mainly to industrial and mining capacity shutting either permanently or temporarily or moving offshore. Unfortunately, we see no change in this downward trend.

Table 5: KICs Customers and Sales Decline Between 2008 and 2020

Customer Category	Number of Customers		Customer Delta	Sales per Category (GWh)		Sales Delta
	FY2007/08	FY2019/20	%	FY2007/08	FY2019/20	%
Industrial	2 966	2 684	-9.5	61 510	45 610	-25.8
Mining	1 153	961	-16.7	32 373	28 703	-11.3
Traction/Rail	510	475	-6.9	2 990	2 600	-13
TOTAL	**4 629**	**4 120**	**-11**	**96 873**	**76 913**	**-20.6**

Data Source: Eskom Annual Reports 2008 and 2020 (*See page 220 and 151, respectively)*

Eskom's prices are increasingly becoming unaffordable for a large part of our membership. Electricity presently makes up between 15% to over 50% of the operating costs of energy-intensive industrial and mining operations. The recent price increases further erode our international competitiveness and lead to Eskom's death spiral.

As NERSA considers this application it will be imperative to consider the impacts to the consumers that may lead to the death spiral for Eskom.
