



Eskom RCA applications 2020

Mornè Mostert | February 2020



RCA application

AFRIFORUM

- AfriForum NPC (a non-profit company) registered in South Africa with, among other aims, constructive participation in matters of Government, such as the making of submissions regarding applications for revenue by Eskom on behalf of its members and in the public's interest.
- AfriForum has been active in the energy industry for several years by making submissions regarding applications for electricity price increases on Local Government level, as well as participating in various public hearings in this regard held by NERSA.
- Has more than 235 000 members and 140 branches across South Africa that actively take part in service delivery issues, including electricity supply.

RCA application

BACKGROUND

- Eskom as company has an obligation not only to generate power but to do it in such a way that it is effective, affordable and prudent. ESKOM has a further obligation to only incur lawful operational and capital expenditure in execution of its licensed activities;
- Eskom is a profit generating company.
- NERSA is a juristic person that has the authority to regulate the monopoly on electricity.
- NERSA has the authority to consider Eskom's applications with input from stakeholders, communities, organisations, etc.
- The MYPD methodology and specifically the RCA is subject to ERA

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ERA CRITERIA

15 Tariff principles

- (1) A licence condition determined under section 14 relating to the **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;

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MYPD CRITERIA

17.1 Risk Management Device

17.1.1 The risk of excess or inadequate returns is managed in terms of the RCA. The RCA is an account in which all potential adjustments to Eskom's allowed revenue that has been approved by the Energy Regulator is accumulated and is managed as follows:

17.1.1.1 The nominal estimates of the regulated entity will be managed by adjusting for changes in the inflation rate.

17.1.1.2 Allowing the pass-through of **prudently incurred primary energy costs** as per Section 12 of the Methodology.

17.1.1.3 Adjusting capital expenditure forecasts for cost and timing variances as per Section 17.2.6 of the Methodology.

17.1.1.4 Adjusting for **prudently incurred** over or under-expenditure on operating costs as may be determined by the Energy Regulator.

17.1.1.5 Adjusting for other costs and revenue variances where the variance of total actual revenue differs from the total allowed revenue.

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GUIDELINES FOR PRUDENCY ASSESSMENT

6.1.1 Prudency of Costs

6.1.1.2 Whether a cost is prudently incurred depends on **how the decision to incur the cost was made**, not only the outcome of the decision.

6.1.1.3. In assessing prudency, the following will be considered:

- a) costs incurred in a **corrupt and dishonest manner**, of obvious wasteful expenditures, will be excluded;
- b) expenditures that meet a standard of care which a **reasonable person** would be expected to exercise under the same circumstances encountered by a licensee at the time of decision had to be made; and
- c) actions that would be considered reasonable by a person with similar skills and knowledge under similar circumstances.

6.1.2 Efficient Costs

6.1.2.1 Efficient means performing or functioning in the **best possible manner** with the least waste of resources given prevailing conditions, as well as having and using requisite knowledge, skills and competence

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ESKOM GROUP INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2019

- **Interim Financial statements September 2019**
 - “The significant estimates and judgements made by management in applying the accounting policies and the key sources of estimation **uncertainty** were substantially the same as those applied to the **financial statements** as at and for the year ended 31 March 2019.”
- Eskom integrated report and Annual Financial statements 2018
 - It is mentioned in the Integrated Report that Eskom’s external auditors (SizweNtsalubaGobodo Inc) issued a **Qualified Audit**.

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INTERIM FINANCIAL STATEMENTS SEPTEMBER 2019

- The Independent auditor's opinion is summarized as follows:
 - Prior-year restatement due to non-accounting for assets built by customers.
 - Uncertainty that may cast significant doubt on the group's ability to continue as a going concern (similar to emphasis of matter).
 - **Incomplete reporting of irregular expenditure.**
 - No reporting requirement at half-year.
 - **Incomplete reporting of irregular expenditure, fruitless and wasteful expenditure and losses due to criminal conduct.**

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ESKOM GROUP INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2019

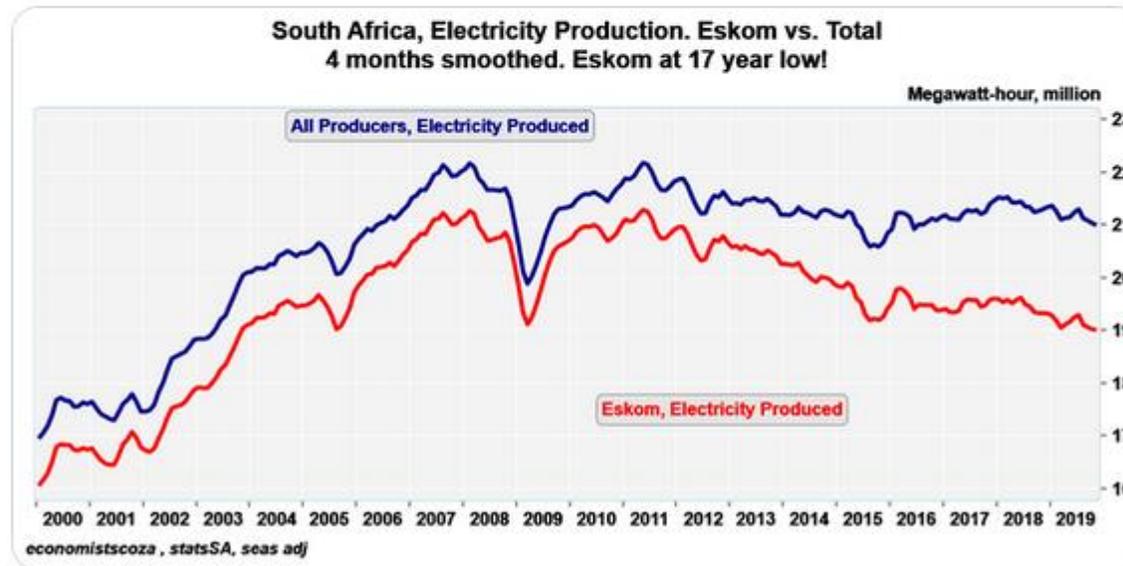
- Reasons for irregular expenditure is provided. These *inter alia* include the following:
 - Use of sole source.
 - **Tender process not adhered to.**
 - Incorrect classification as emergency procurement.
 - **Tender process not followed and insufficient delegation of authority.**
 - Modifications exceeding allowed amounts.
 - **Incorrect tender process applied.**
 - Tax clearance certificates. This aspect revolved more around foreign vendors.
 - **Contracts not in accordance with National Treasury guidelines.**
 - **Commitments made before approval.**

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Eskom produced less power in the last 4 months than at anytime in the last 17 years! The December data is likely to be worse but the 4 months to November was the lowest Eskom produced power in since October 2003! Low levels of production make paying debt a tax payer problem!



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ESKOM GROUP INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2019

- It was mentioned in Eskom integrated report and Annual Financial statements 2018 that the invoiced municipal arrear debt (including interest) has increased in 2018 by **R4,2 Billion to R13.6 Billion**.
- Overdue debt owed to Eskom by municipalities increased by some R1.2bn in September to **R26.4bn** by the end of October, Parliament's Standing Committee on Public Accounts heard from the inter-ministerial task team aimed at resolving the debt owed to the power utility. - Fin24 (Municipal debt to Eskom grows by over R1bn in a month)
 - <https://www.fin24.com/Economy/South-Africa/council-debt-to-eskom-grows-by-over-r1bn-in-a-month-20191203>
- Eskom debt has dramatically increased from **R389 billion** in March 2018 to more than **R450 billion** in September 2019.(Eskom group interim results for the six months ended 30 September 2019)

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BORBET CASE

The Borbet Judgment made it clear in paragraph 110 that NERSA's task "is to maintain a **balance** between Eskom's sustainability as a business and **reasonable** tariff stability as well as to appropriately allocate commercial risk between Eskom and its customers. That is not to say that NERSA is obliged to approve variances due to **maladministration** on Eskom's part.

Paragraph 119 continues: "I appreciate that the South African taxpayer and electricity consumer are exhausted by the constant historical failures by ESKOM. Whether ESKOM is penalised by NERSA through the imposition of a fine or whether a request a tariff adjustment is granted or denied, the taxpayer and the consumer ultimately appear to be the ones who bear the financial burden. ESKOM is a strategic national asset. What is **required** from it is **optimum efficiency** and **accountability**. **NERSA** and its sole shareholder, the government, are tasked to ensure that **result**."

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NERSA AND ESKOM COURT CASE REGARDING 69 BILLION BAILOUT

- Adv. Chaskalson SC made certain arguments on behalf of Eskom
- Adv. Chaskalson SC explained that section 15(1)(a) created a framework whereby a “**reasonable operator**” may recover full cost of licenced activities
- Given the description above does Eskom meet the bar of “reasonable operator”?
- It is important to take note of the arguments made by Eskom during this matter regarding Eskom’s approach to Public participation process of Nersa.
- Eskom believes that the tariff making process (whereby the RCA falls within the ambit of Section 15(1)(a) of ERA) is a purely mathematical equation.
- AfriForum submits that Nersa must take into account the impact of its decision will have on the consumers and the South African economy. We request that this will form part of the reasons published by Nersa.

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CONCLUSION

- This submission aims to ensure that imprudent costs/expenditure incurred by Eskom is not passed on to consumers by way of tariff increase or RCA applications.
- AfriForum believes that prudent decision-making goes further than pure lawful decisions. It is a higher bar to pass. It is submitted that Eskom does not meet the efficiency standard as set out by ERA and Borbet-case.
- Furthermore, the gap between an “efficient operator” (as described by Adv. Chaskalson SC) and Eskom has been growing for more than a decade.
- That NERSA fulfils its mandate by regulating the management of energy and its tariffs by using mechanisms and remedies at its disposal to ensure efficient, economic and effective use of resources, as set out in the Constitution.
- Advocating for the efficient, effective and prudent decentralisation of generation, distribution and transmission activities from Eskom to independent power producers, distributors and transmitters.

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AFRIFORUM ACTION PLAN

- AfriForum is in the process of completing a model to increase Eskom's collection rate from municipalities and other state organs.
 - This remedy will fall within the ambit of Rule of Law and the principle of legality
 - And would ensure that Premiers of the province complies duties of the Constitution
- AfriForum through its branch structures will take part in Municipalities' Integrated Development Plan (IDP) and budget processes to ensure the inclusion of an amount outstanding to Eskom.
- To Investigate all Cost of Supply documentation of Municipalities not only to see if they do comply with their own license conditions but to ensure that they are substantive in nature.