

2020

EIUG Comments on Eskom's Revenue Clearing Account for 2018/19

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WHO ARE WE

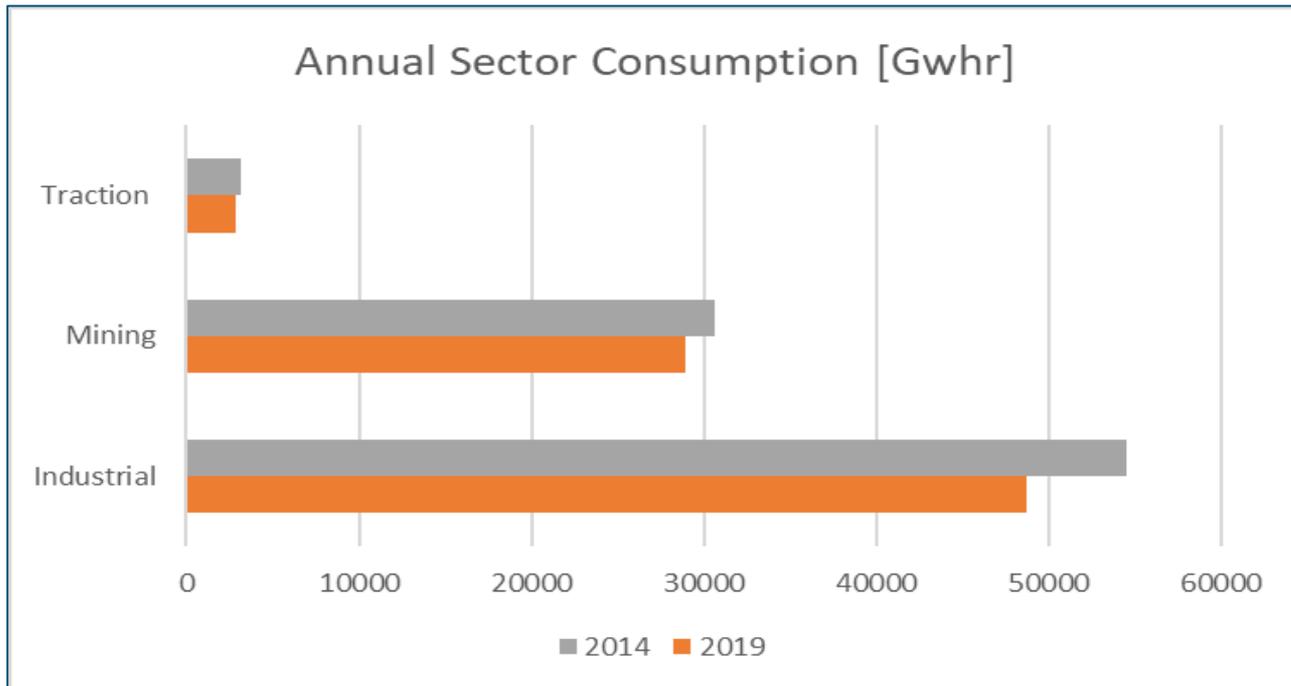
Established in 1999, the EIUG is a voluntary, non-profit association of 28 energy intensive consumers whose members currently account for over 40% of the electrical energy consumed in South Africa. Our members collectively contribute over 22% to the GDP of South Africa, employing some 658 000 South Africans with a collective SA turnover of R 685Bn.

The EIUG has significant technical expertise on energy matters. It is a respected and non-partisan organisation dedicated to working towards a sustainable electricity supply industry.

Key focus for the EIUG is:

- Quality of Supply - The EIUG engages with suppliers to ensure that the supply of energy adheres to the prescribed standards.
- Reliable Supply - The EIUG is dedicated to working with the relevant stakeholders to ensure the uninterrupted supply of energy.
- Affordable Energy - Internationally competitive energy tariffs that are affordable and sustainable.

FIVE YEAR AFFECT ON INDUSTRIAL, MINING AND TRACTION CLIENTS



In 5 years Eskom sales have decreased;

Industrial power consumption	10,7%
Traction power consumption	9,4%
and Mining	5,5%

This is a significant loss of Eskom's paying customer base and a continuation of the trend starting with Eskom's first above CPI increase in 2009.

INTRODUCTION

- ❑ The Multi-Year Price Determination (MYPD) Methodology is designed to regulate the revenue required by Eskom to operate efficiently and remain sustainable.
- ❑ Eskom with its debt burden is no longer a sustainable business and the MYPD methodology can no longer be used to regulate a technically insolvent business.
- ❑ Eskom costs are out of control and cost increases as proposed by Eskom cannot be afforded by consumers

Eskom increases need to be CPI linked and affordable to the South African consumer to allow all parties to plan and generate a return such that the ongoing raising of the price of electricity is contained, on going manufacturing industry closures are stopped and Eskom can profitably sell what electricity it can produce

KEY ISSUES

1. Energy Availability Factor
2. Primary Energy and Coal
 - 2.1 Coal Costs
3. Open Cycle Gas Turbines
4. Staffing
5. Transmission
6. Distribution
7. International Imports
8. Exports
9. Generation Capex
10. Independent Power Producers

1. ENERGY AVAILABILITY FACTOR [EAF]

- ❑ From a technical perspective this lack of availability is why Eskom cannot supply, and the technical reason for increased operational costs and primary fuel consumption.
- ❑ The EAF was assumed at an average of 79% for FY 2019 while only 69,96% was achieved. This low EAF is the dominant reason for the lack of sales and a core reason for the utility death spiral as illustrated by the following chart indicating Eskom sales decline and cost increases.

ESKOM'S PRICE V SALES

Sales Exclude International Sales

Year		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Sales	GWh	194799	204531	210458	201202	205364	211150	211590	202770	205525	204274	201022	199028	196922	195858
Ave Price	Rc/kWh	17.02	18.06	19.43	24.71	32.05	40.49	50.51	58.81	63.47	68.29	76.18	82.73	83.62	86.3541

- ❑ As the EIUG we are familiar with old plant > 40 years old but still generating good returns due to prudent operation in the most part.
- ❑ The low EAF is one of the reasons for the use of Arnot, which was not planned.

The application does not elaborate on how Eskom intends scientifically improving the EAF and creating space in the generation profile for refurbishment of good generation assets. The implication is that the death spiral will accelerate in the coming years until Eskom is restructured to allow more prudent management practices.

2. PRIMARY ENERGY AND COAL

- ❑ Total sales to customers was 208 779 Gwhr vs planned sales of 212 701 Gwhr [Not markedly off plan]
- ❑ Primary energy costs were R 99 489m vs NERSA allowed costs of R 86 094m for primary fuel.
 - ❑ Eskom in essence used some R 13 395m more on primary fuel than NERSA considered prudent despite generating 1,8% less electricity than planned.
- ❑ Eskom's planned coal burn cost were R 0,245 R/kwhr vs actual of R 0,262 R/kwhr, however coal purchases are at R 0,275 R/kwhr, a **12,34 %** increase in costs purely attributed to coal procurement costs.

High coal procurement costs are predominately as a consequence of the move away from cost plus and long fixed term contracts to short and medium term contracts

2.1 COAL COSTS

Cost plus contracts

The most cost effective, where only 33% was supplied against a budget of 38% mostly because of limited funding. Eskom “was forced” to continue to reprioritise its capital expenditure programme in these mines resulting in reduced production.

Long term fixed contracts

25% of the coal was sourced in this fashion vs a budget of 32%. No reasonable explanation is provided for the decrease in procurement from the second cheapest form of contract.

Short and Medium-term contracts

This expensive form of coal contracting supplied some 42% of the coal procured and is a considerable cause of Eskom’s malaise. Eskom has limited coal quality measuring equipment and poor-quality coal will be a significant cause of the low EAF numbers inflicting Eskom.

Other

- Kusile, one of Eskom’s flag ships, does not have a long-term coal supply agreement.
- A forensic audit and follow through of the short- and medium-term contracts along with the transport requirements would go a long way to reducing coal costs.

3. OPEN CYCLE GAS TURBINES [OCGTs]

- ❑ Load shedding would have increased from 812.2 Gwh by a further 859.5 Gwh had the renewables and OCGTs not been used.
- ❑ The EIUG would request a closer investigation of the use of the OCGTs for load management during the March 2019 period, when imports were low and **only some** exports [unregulated income] were restricted whilst the country was load shed.
- ❑ The use of OCGT increased costs of R 3 768m vs allowed costs of R 345m [generator volumes of 1 202 vs 105 Gwhr].
- ❑ Greater reliance on OCGTs to replace the water (energy) from the pumped storage stations and the requirements to utilise OCGTs at the weekend in preference to water to ensure that the full generating capability is restored at the beginning of each week, is a further indicator of lack of capacity in the generation profile resulting in the use of expensive assets in place of more cost effective equipment.
- ❑ OCGT costs have been further escalated by the April 2016 National Treasury decision to reduce the fuel levy rebate applicable to OCGT fuel from 100% to 50%.

4. STAFFING

Limited reduction in staff is evident with a very significant corporate presence of 6 992.

Performance of staff in terms of output per employee has clearly not received much attention. This is particularly the case in Distribution, where despite high staff numbers Eskom admit to a low planned maintenance regime. The utilization of expensive staff clearly needs attention and although money is spent on skills training its benefit is not quantified.

The EIUG is concerned with the stability of top management within Eskom. It is extremely important for the operation of Eskom, under trying circumstances, that competent managers are supported in their endeavours to maintain the Electricity Supply Industry.

5. TRANSMISSION

- ❑ Only 34% of capex allocated to Transmission was spent.
- ❑ Nersa allowed an expenditure of R 9 009m vs a request of R 11 492m of which only R3 062m was spend.
- ❑ It is recommended that Eskom be required to spend the R 5 947m funds reallocated in this determination period to prevent the Generation malaise occurring in Transmission.

This reallocation of funds by Eskom is clear reason for Transmission to be separated out of Eskom as quickly as possible such that it can control its own destiny before rampant failure of the Transmission network compounds the generation problem.

6. DISTRIBUTION

- ❑ Eskom only spent 62% of the Distribution maintenance budget request and,
- ❑ The maintenance philosophy in Distribution is predominantly unplanned to help to negate the Eskom funding shortfall !
- ❑ of a total OPEX cost 29% [R 24 510m] is attributable to bad debt.

Coupled with load shedding this is a recipe for further Eskom malaise and potential injury liability.

It is clear from the Transmission and Distribution explanatory notes that monies allocated by NERSA for use by Transmission and Distribution were reallocated. If nothing else this supports a change in the regulatory process and the separation of Transmission and Distribution from Eskom to focus on the these assets.

7. INTERNATIONAL IMPORTS

- ❑ The RCA is unclear on the volumes imported but clear that R 524m more than the R 3 216m allowance was spent.
- ❑ Despite this over expenditure the RCA indicates a shortfall of 2 000 Gwhr that should have been imported.
- ❑ SA is still at risk as the 2nd line from Cahora Bassa is defined as only to be repaired sometime during 2020.
- ❑ The lack of import from Mozambique in March 2019 through natural occurrences clearly had major influences on SA load shedding and OCGT utilisation.

8. EXPORTS

- ❑ 12 367 Gwhr was exported in 2019 to most Southern African countries through SAPP.
- ❑ The RCA neglects to inform NERSA of the income and indeed the losses “arrear debt” incurred [Restricting supply to ZESA of Zimbabwe implies lack of payment] which is not elaborated on.
- ❑ From a technical perspective Export sales are slightly less than expensive OCGT operating hours i.e. 13 634 Gwhr of OCGT vs 12 367 Gwhr of export.
- ❑ Hopefully exports were at least as profitable as the operating cost of the OCGTs at R 3 768m, but the RCA is silent on the income generation or lack thereof by Eskom, *as this is an unregulated business.*
- ❑ Exports to Zimbabwe [ZESA] occurred during the March load shedding period “Eskom initially curtailed the load to Zimbabwe to 150MW per hour of each day from 28 March 2019 between 300-400MW per hour day. pg. 49” What is unclear from this description is the extent and as to whether other exports occurred during the load shedding periods, which is likely given the relative size of ZESA [3.7%] in the overall export business.

This source of export income needs significant elaboration as well as the philosophy of exporting whilst load shedding in South Africa due to power shortages.

9. GENERATION CAPEX

- ❑ Eskom applied for R 50 405 generation capex of which R 39 064 was defined as meeting the definition of Work Under Construction.
- ❑ Nersa allowed R 29 388m of the R 39 064.
- ❑ During 2019 Eskom spend R 26 450m on generation capex as opposed to the R 16 671 approved by NERSA for generation capex. Probably resulting in the lack of capex expenditure in both Transmission and Distribution.

10. INDEPENDENT POWER PRODUCERS

- ❑ Costs of R 26 655m vs allowance of R 26 596m and,
- ❑ Planned output of 11 679 Gwhr vs actual output of 11 344 Gwhr were achieved.
- ❑ Cost and production very close to plan.

Had the IPP uptake not been delayed by Eskom during the review period, the positive impact of IPP operation would have been greater and some of the OCGT expenditure could have been avoided.

CONCLUSIONS

Eskom is technically insolvent and not a going concern, however SA cannot allow this status to infiltrate into the economy by raising the tariffs to continue destroying the manufacturing sector.

Revenue from electricity sales is insufficient to service the R460-billion Eskom debt and Eskom must finally manage;

- ❑ aggressive cost-cutting,
- ❑ operational inefficiencies,
- ❑ gross irregular expenditure,

to improve its cost management and bring costs in line with tariffs.

The MYPD rules are not applicable to an entity that has consistently not addressed allegations of corruption, governance failure and disclosures of maladministration and the consequences of this inaction on the business.

EIUG RECOMMENDATIONS

- ❑ That NERSA establish a 5-year forward price to cover the period of restructuring. This to be CPI linked and affordable to the South African consumer to allow all parties to plan and generate a return such that the price of electricity is contained, manufacturing closures are decreased and Eskom can sell what electricity it can produce.
- ❑ for Eskom to address cost cutting and challenge its developmental mandate to reduce costs.
- ❑ for Eskom to return to cost plus mines and install coal quality measuring in all stations.
- ❑ for the Department of Public Enterprises to restructure Eskom to prevent the drain of necessary funding from Transmission and Distribution.
- ❑ for Government to urgently address the lack of payment culture.
- ❑ for the Department of Mineral Resources and Energy to create capacity for Eskom to refurbish good and retire old plant through facilitating power plant development.
- ❑ for Treasury to review the decision to decrease the rebate on diesel for power generation.

Eskom is silent on the recovery of assets from individuals that have benefited from illegal activities. Indications are that this is a significant source of revenue which should be accounted for and urgently returned to Eskom to decrease the operating cost.

Re a leboha

Ro livhula

Siyabonga

Ha khensa

Enkosi

Siyathokoza

Thank you

Dankie

Re a leboga