

# Eskom RCA Application 2018/2019

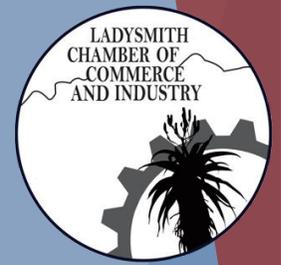
Public Hearing, 6 February 2020, ICC, Durban



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# Introduction

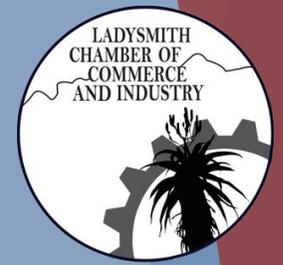
- ▶ Third largest chamber in South Africa
- ▶ Representing 800+ members of all sizes and across all sectors
- ▶ Representative and unified organisation - amalgamation of 3 organisations in 2002 - Pietermaritzburg Chamber of Commerce & Industry; Midlands Black Business Chamber and the Pietermaritzburg Sakekamer
- ▶ Significant manufacturing in and around the city
- ▶ Submission supported by the Ladysmith Chamber (representing Ladysmith and Estcourt)



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# Sec 17 of MYPD Methodology

- ▶ Intended to “mitigate and manage the risk of excess or **inadequate** returns” taking **inflation** and **prudently** incurred primary energy and operating costs into account - it is not designed to give Eskom a blank cheque, to enable Eskom to act with impunity and to recover mismanaged funds and/or funds lost to corruption;
- ▶ Minister Gordhan is quoted in a Fin24 article saying that consumers are paying 4 times more for electricity than they should be, because of stealing at Medupi and Kusile - it’s a given then, that consumers are already paying too much, i.e. there has already been an over-recovery.
- ▶ Electricity prices have increased more than 300% in the last 10 years, whereas inflation ranged between 4.62% and 6.34%

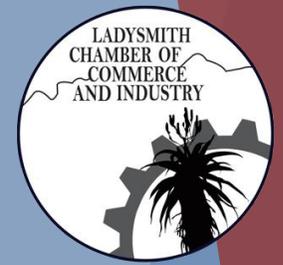


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# Revenue Variance

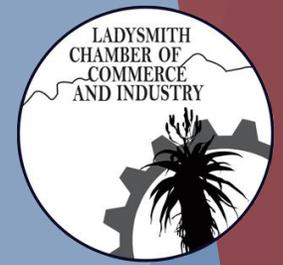
➤ Eskom maintains that “variance is not a matter of prudence, efficiency or reasonableness with regard to the actual outcome, but at most a matter of inaccurate forecasting of an uncontrollable matter - irrespective of whether such lower demand was caused by **underestimation of price elasticity**, **lower economic growth**, commodity cycles, **capacity constraints** etc.” - this might be acceptable if Eskom were not themselves largely to blame for the price elasticity response, lower economic growth and capacity constraints, which they definitely are - none of this is uncontrollable - it’s perfectly controllable by sound management. It’s a direct result of Eskom’s mismanagement and corruption and cannot be accommodated.



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# Revenue Variance: Price Elasticity of Demand

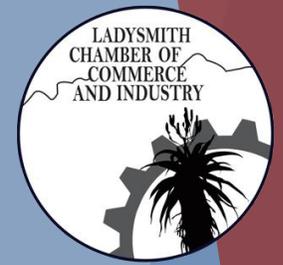
- ▶ The price elasticity of electricity demand was considered fairly inelastic when price hikes were reasonable, but when the price of electricity (in real terms) started to rise sharply post 2007, price elasticity of demand was significant and negative: For every 1% increase in price → there was between 0.2% and 0.5% decrease in electricity demand - Deloitte, 2017.
- ▶ We know the extent to which Eskom have increased their pricing (by over 300%), so it's easy enough to calculate to what extent they have eroded their own revenue - this portion of eroded revenue should be disallowed.



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# Revenue Variance: Lower Investor Confidence & Downturn in the Economy (Lower Economic Growth)

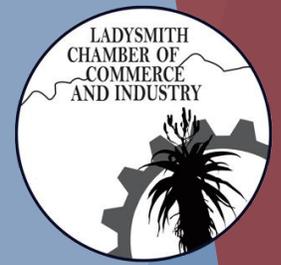
- ▶ A direct result of political & policy uncertainty and economic mismanagement - while it is true that factors such as the proposed Mining Charter had a negative impact on mining and the drought on agriculture, high tariffs, poor management of SOE's and continual reports of unabated corruption contributed significantly to the erosion of investor confidence - significant responsibility must be born by Eskom - these are not simply external factors as they'd have us believe.
- ▶ Exorbitant tariffs and insecurity of electricity supply are definitely impacting growth and exacerbating the situation. Mining and industry are power intensive. High electricity tariffs and load shedding added significantly to the cost pressures that have led to industry closures.
- ▶ There is no doubt that Eskom played a significant role in the economy's downturn. Making us pay when Eskom's culpable is a double-whammy for Business and ordinary South Africans.



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# Revenue Variance: Capacity Constraints

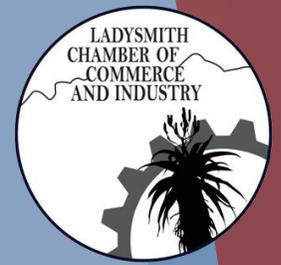
- ▶ Eskom's fleet performance has deteriorated due to a lack of maintenance and refurbishment over the years, greatly compromising the security of electricity supply. This is pure mismanagement of which the deterioration in revenue is a consequence. There is no prudence here.
- ▶ Medupi and Kusile, projects conceived in 2007, were supposed to be completed by 2015 at a cost of R163bn, but are still not finished. They are now reportedly only expected to go fully online after 2021 and 2023 respectively, with costs ballooning to more than R450bn - whose fault is this?
- ▶ Eskom are responsible for the capacity constraint.



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# Revenue Variance: Energy Availability Factor (EAF) Assumption Not Met

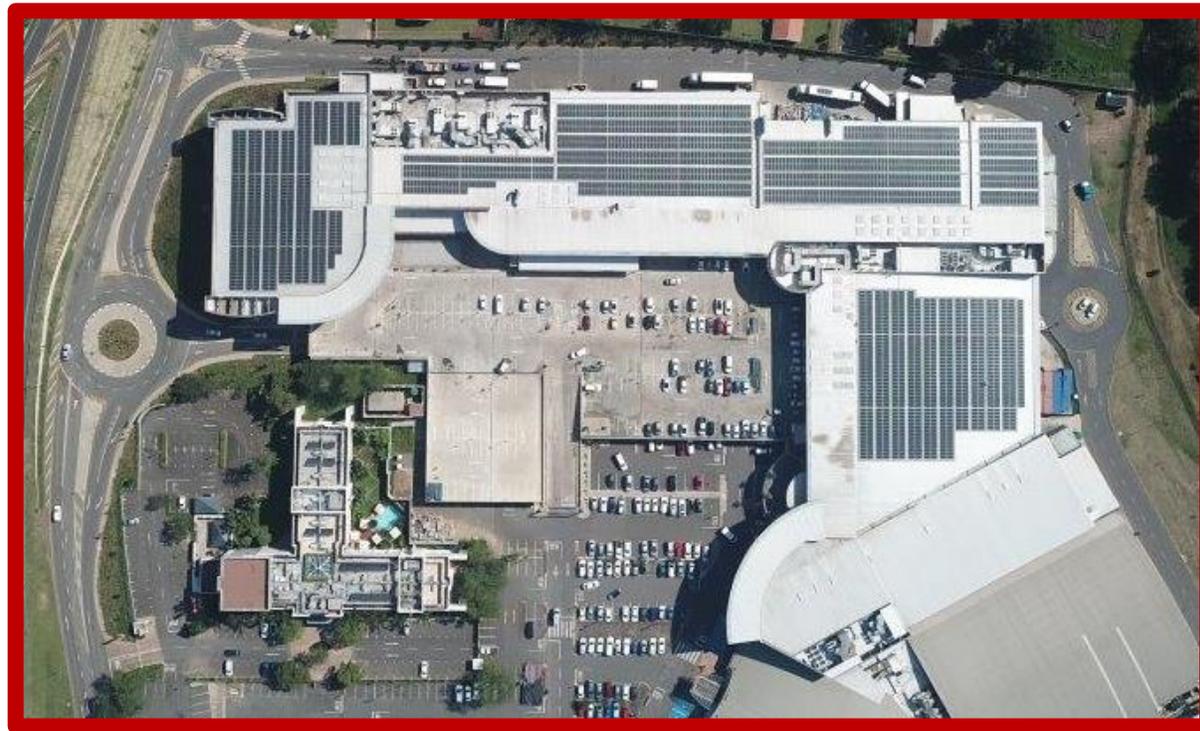
- ▶ This implies that the assumption was unrealistic
- ▶ The EAF has been in decline since 2001
- ▶ Energy experts say that Eskom has a R20bn maintenance budget a year and estimate that the value we're enjoying amounts to about R5bn pa = 75% efficiency wastage on the current maintenance budget - this needs to be interrogated
- ▶ The 79% EAF anticipated did not materialize due to poor plant performance, a lack of maintenance and insufficient supply from the disastrous new-build programme - this wasn't a set of unfortunate circumstances that Eskom had to weather, it is the consequences of mismanagement and corruption - why must the consumer bear these costs?



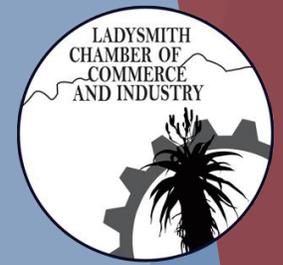
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# Revenue Variance: Lower Sales Volumes:

Eskom cites lower sales volumes as a factor, but Eskom created these lower volumes (they are self-inflicted) by not having the energy available to sell → insecurity of supply and by driving electricity prices up unreasonably they've forced customers to make alternative energy investments (e.g. large solar plants) - it's self-defeating.



*R12 million solar photovoltaic (PV) plant at the Liberty Midlands Mall*

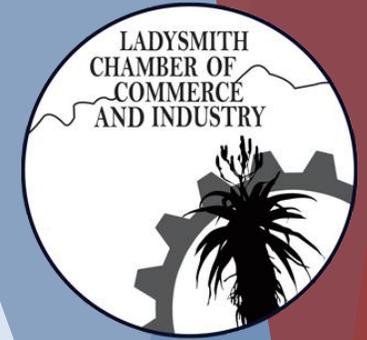


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*Belgotex has invested over R20 million to date in solar power*



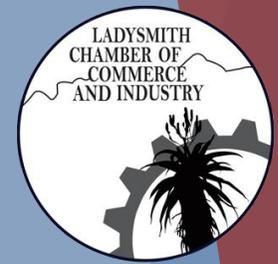
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# Revenue Variance: Ghost CDU's

- Ghost CDU's are cited as a contributing factor to a loss in residential sector sales - these can be traced directly back to Eskom employees - it's corruption plain and simple - how can this not have been addressed and why should the private sector carry the cost of this? This should definitely be disallowed.

# Revenue Variance: Load Reduction Adjustment for Load Shedding

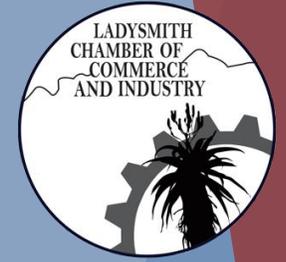
- Eskom say they have included a load reduction adjustment to accommodate revenue not realised during load shedding, but they haven't accounted for the sales losses as a result of load shedding - load shedding has had a negative impact on growth, which has driven down demand - there is a strong correlation between GDP growth and electricity sales in South Africa (1% increase in GDP → 1% rise in electricity demand, and the opposite holds true, Deloitte, 2017).
- CSIR Report: there were 530 hours of load shedding in 2019 at a cost to the economy of between 59 and 118 bn Rand



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# Key Cost Variances: Coal; OCGT Fuel

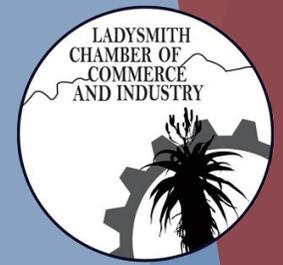
- Coal procurement practices are questionable - reports of emergency procurement in order to bypass tender regulations); paying inflated prices; the eroding of stockpiles; supply issues; quality of supply issues; the incurring of unnecessary transport costs etc.
- M & G article (10/2019) revealed Eskom has 16 coal-producing companies that will supply 70mn tonnes coal in the next 6 years for more than R38bn - they estimate that this is R10bn more than the averaged cost per tonne, because some suppliers are charging hugely inflated prices (up to R980 per tonne - and you can't tell us that this is just about quality rating). If the NERSA guideline is R350 per tonne delivered, then how can Eskom be paying these prices with our money? With the quantities that Eskom orders there is no excuse for the negotiation of such contracts - the contracts need to be interrogated, someone held accountable, and Eskom needs to be limited to recovering only what is prudent and reasonable.
- The excessive claim for OCGT Fuel has been justified by the fact that it mitigated some of the load shedding, like load shedding is a normal state of affairs - load shedding is a direct consequence of mismanagement, this is not an expense incurred in the ordinary running of such an enterprise - this just adds insult to injury - the consumer must pay to protect themselves from Eskom's failures.



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# Recovery of Fixed Costs: Debt & Interest Repayment

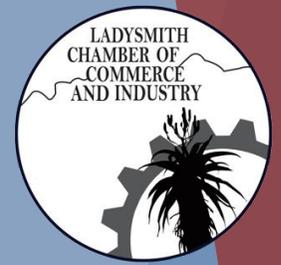
- ▶ Debt has grown to R450 billion and we are servicing long-term capital requirements with short-term loans.
- ▶ The debt levels are reckless and irresponsible and I don't think that they can all be operationally justified. With all the reports of inefficiency, maladministration and corruption, who is to say what percentage of these debts have been prudently incurred and properly structured? This need to be interrogated before there is any recovery permitted. The private sector cannot be expected to finance maladministration and/or corruption.



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# Key Cost Variances: Operating Costs: Depreciation & Maintenance

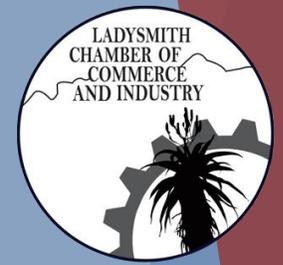
- ▶ The Regulatory Asset Base is over-stated (capitalisation of excessive and unjustifiable capital spend rather than real value of the asset). Nersa adjusted the RAB value, for good reason.
- ▶ Apart from the mismanagement of the maintenance budget, the failure to carry out midlife refurbishments has had dire consequences in terms of costs and asset values.
- ▶ By the Minister's own admission, plants weren't only damaged by poor and irregular maintenance: the company's people management system also caused damage to power stations, due to a loss of skills and the creation of patronage networks - he said " many good people have left and are working in the Philippines and elsewhere. And what I heard is that the then-management replaced power station managers so that they could control procurement..." - there is no way that we can say that maintenance expenditure was prudently incurred.



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# Key Cost Variances: Operating Costs: Employee Benefits

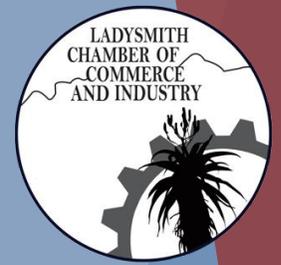
- ▶ No of employees should be aligned to sales volumes
- ▶ According to the World Bank, there are 66% too many employees at Eskom. There were 39292 employees (2019) ➡ 25000+ too many people
- ▶ If the shareholder is dead-set against retrenchments at Eskom, when it is blatantly obvious that Eskom is bloated and that the staff complement is driving up costs irrationally (at the expense of jobs in the private sector), then the Shareholder should find the money to remunerate the excess staff and call it what it is - wasteful expenditure
- ▶ Staff at Eskom are overpaid - A World Bank study in 2016 found that South African utilities pay workers more than double the norm in 35 other countries on the continent - costs should be limited to reasonable compensation.
- ▶ If Eskom was privately owned, there would not only have been retrenchments, but there would have been no increases for workers either, certainly nothing above inflation - the results don't allow for it. Any approved increase above inflation should be disallowed (it's not prudent and it's definitely not affordable).



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# Conclusion

- ▶ Sec17 of the MYPD Methodology intends to “mitigate and manage the risk of excess or **inadequate** returns” taking **inflation** and **prudently** incurred primary energy and operating costs into account - it is not designed to give Eskom a blank cheque, to enable Eskom to act with impunity and to recover mismanaged funds and/or funds lost to corruption;
- ▶ The Private sector cannot afford to fund inefficiency, maladministration and/or corruption, and it shouldn't be expected to.
- ▶ If this burden is imposed on us, I can assure you, jobs will be lost. This is not sustainable for South Africa
- ▶ Seeking to recover the results of poor(mis)management from consumers is ludicrous and making consumers pay even more is just reinforcing the negative, unsustainable cycle for Eskom, it's completely irrational. Increasing electricity pricing is not prudent and it's not sustainable.
- ▶ If this is permitted, then we're knowingly contributing to the destruction of Eskom and our economy and negatively affecting the lives of every South African now and into the future. We can't afford to bail Eskom out in the short term at the expense of future South Africa.



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