SALGA Response to Eskom Regulatory Clearing Account for 2018/19

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Introduction

- Eskom applied for an RCA balance of R27 323m in its favour for financial year 18/19 .
- NERSA Published Eskom RCA Application for Stakeholder comments in December 2019, including the schedule for public hearings
- SALGA submitted local government comments and position on the application on 20th January 2020
- SALGA plan to present the position in the NERSA public hearings in Feb 2020

Background

- In the past years SALGA has presented the LG positions on the Eskom's ever increasing tariffs
- We have repeatedly raised the same issues on impact of the tariff increases, more especially in municipalities and the communities they serve.
- SALGA has also raised challenges in the operational environment within which the municipalities are operating, some by the very existence of Eskom within their jurisdictions, some regulatory & policy related, structural and systemic issues etc.
- Raised issues of eroding sales and revenues over the years, increasing losses and theft resulting in rising debt owed to Eskom as well to munics.
- With all these realities, the municipalities remain the common factor where criticism towards this industry is concerned.
- The industry challenges remainsthe same for the past 20 years without any major or drastic changes

Background…2

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- Our Utilities and Distributors have reached a death spiral phase
- With escalating prices and zero service offerings that incentivizes customers to stay in our grids, we are pushing ourselves out of this business
- Metro's and secondary cities have for years been recording and reporting drastic reduction in sales and revenue
- Have recorded loss of Large Power Users who prefer to have their own power supply options
- The unreliability of supply, capacity shortages and reduction in technology prices is incentivizing able customers to move out of our grids
- Without any key policy and regulatory changes that allow total rehaul of the industry as we know it, the municipalities and Eskom will only be left with the poor and non paying customers, who have no choice but to stay.
- We need pro-active policies and regulations in the industry not reactive

Some other effects

- In their budgeting processes, NT always caution municipalities about CPI when drawing their budgets and setting tariffs for their services but
- Eskom Bulk Tariffs have for the most times been way above CPI if not doubled.
- Energy costs serve as one of the main drivers for water distribution and have a direct knock on effect on Water board tariffs.
- The bulk tariffs that must be paid by municipalities to Waterboards are also almost double the CPI - a great example of structural challenges munics have to deal with on a daily basis
- Water boards have projected their energy costs above 8,1% with a condition that their final tariff applied will be based approved Eskom tariff.
- The average tariff increase application for the 9 WBs has been 8.6% and no doubt will shoot up with the anticipated decisions on Eskom tariffs
- Municipalities therefore do not only have to contend with the Eskom tariffs but also with secondary impacts of the tariff passed downn by other bulk utility suppliers within the resources value chain.

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Recent Decisions

- On 14 June 2018, the Energy Regulator approved a total RCA balance of R32.69 billion for the
- three years as follows:
  - an RCA balance of R12.577 billion for the 2014/15 financial year;
  - an RCA balance of R12.058 billion for the 2015/16 financial year; and
  - an RCA balance of R8.055 billion for the 2016/17 financial year.
- On 2 October 2018, NERSA issued a statement on the liquidation of the above RCA balances.
  - Eskom will recover R7 776m from Standard tariff customers from the 2019/20 financial year until the 2022/23 financial year. Everything else remain the same.

The Eskom RCA Application 2018/19

- Eskom for FY 18/19 applied for an RCA balance of R27 323m in its favor.
- Our analysis on the RCA balance for FY1819 is that it can at best be R8 517m in Eskom's favor - what we deem prudent costs that can be claimed

Summary of the RCA with recommended prudent costs

	R'm	Decision 1819	Actual Eskom	Variance	Adjustment	Allowed Variances
1	Total Revenue from Sale of Electricity	189 566	189 727	161		161
	Primary Energy	85 312	101 191	-15 879		
2	Coal Burn	39 177	49 903	-10 726		
	Price Variance			-10 897	545	-10 353
	Volume Variance			171		171
3	OCGT	345	3 768	-3 423	3 423	-
4	Nuclear	499	768	-269		-269
5	Other PE	7 096	8 552	-1 456	1 456	-
	IPP	26 596	26 655	-59		
6	Renewable IPP	24 216	22 364	1 852		1 852
7	DoE Peaking	2 380	4 291	-1 911	1 911	-
8	Imports	3 216	3 740	-524		-524
9	Levy	8 093	7 805	288		288
10	DMP	290		290		290
	Total Other Opex Cost	104 254	106 103	-1 849		
11	Depreciation	24 903	26 427	-1 524	1 524	-
12	ROA	28 117	28 107	10		10
13	R&D	112	90	22		22
14	EEDSM	-	29	-29	29	-
15	Opex	51 122	51 450	-328	328	-
16	SQI					-166
RCA Balance in favour of Eskom						-8 517

Revenue Variance

- Eskom was allowed total revenue from sale of electricity of R190 348m for FY18/19.
- According to note 32 on page 95 of FY18/19 AFS, Eskom realised actual revenue from sale of electricity of R189 727m and other income of R3 073m, therefore total actual revenue of R192 800m.
- When total revenue from sale of electricity is R189 727m before impairment for bad debt which is provided for as part of Eskom operating expenditure, the revenue variance reduces to R621m in favor of Eskom.
- Total actual revenue from sale of electricity should ideally be used to offset operating expenditure in its entirety as Eskom incurred cost in generation rather than from sale of electricity.
- The actual revenue is before any form of impairment or bad debt provision, and is allowed separately as part of operating expenses as para. 97 on page 99 of the NERSA reasons for decision on Eskom FY18/19 revenue application.

Revenue Variance..2

- The additional revenue streams are included as Eskom generates significant amounts of revenue for charging municipalities large amounts when “exceeding” their NMD.
- The intention of the NMD rules and associated penalty is to ensure effective load management by municipalities but the manner in which the NMD charges are administered, these charges seemingly amount to additional operational revenue and should for the purposes of the RCA be treated as such.

Coal Burn

- According to para. 58 page 42 NERSA reasons for decision on Eskom FY18/19 revenue application, Eskom was allowed coal burn of 114.3mt for R49 209m before the R10 033m adjustment. After adjustment total coal burn allowed was reduced to R39 177m
- Eskom actual coal burn was 113.8mt for R49 903m or R438.51/t.
- The total coal burn variance was therefore R10 726m in favor of Eskom.
- Eskom was allowed 114.3Mt coal burn, it however burned only 113.8Mt which was lower by 0.5Mt or 0.04%.
- The coal volume variance which is the difference between actual volumes and allowed volumes multiplied by the allowed price amounting to R171m in favor of the customer; i.e. (114.3-113.8) x R342.76).
- Therefore the above variance is in favor of the customer as Eskom burned less coal than what was allowed.

Coal Burn..2

- Eskom was allowed average coal price of R342.76/t, it however on average paid R338.51/t for actual coal burned of 113.8Mt for a total amount R49 909m.
- Despite the fact that Eskom burned 0.04% less coal, but it paid 27.9% more as a result exceeded the NERSA allowed budget for FY1819.
- In terms of the provisions of the MYPD methodology, Eskom is allowed to pass-through the entire coal variance except for the alpha factor, in terms of which it has to absorb 5% of the price variance.
- The alpha adjusted price variance multiplied by actual volumes; i.e. (-R95.76) x 113.8mt or R10 353 in favor of Eskom.
- **The total alpha adjusted coal burn variance consist of an alpha adjusted price variance of R10 353m in favor of Eskom and a volume variance of R171m in favor of the customer**.

Coal Burn..3

- Eskom for FY17/18 applied for R56 642m but was allowed only R46 992m by NERSA i.e. allowed coal burn cost for FY1718 was 11.9% or R6 728m less than what Eskom had originally applied.
- The actual coal burn cost was even lower than what NERSA had allowed Eskom by a further R2 922m applied.
- The favorable coal price variance should therefore be allowed as Eskom management is starting to be responsive to our cry for prudent coal contract management.
- The actual average coal price for FY18/19 was R438.57/t therefore 7.8% higher than actual average coal price achieved in FY18/19 of R406.87/t.
- The increase in coal price between the two years was just above inflation.
- This is further evidence that Eskom is adapting to the prudent regulatory practices.
- Eskom should therefore be allowed the alpha adjusted coal price as it is starting to be responsive while on the other hand any further adjustment to allowed coal cost may compromise its ability to further enhance its coal contract management practices.

Open Cycle Turbine Use

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- The demand for electricity in FY1819 was lower than in FY1718 and the only reason why Eskom had to rely more on OCGT utilization is because its actual energy availability factor (EAF) at 69.95% , way below par and is even lower than EAF of 78% achieved in FY1718.
- It would therefore not be prudent for Eskom to be compensated for its own inefficiencies, the entire over expenditure of R3 423m should therefore be disallowed.
- According to para. 51 on page 36 of the nersa RFD, the targeted Energy availability factor (AEF) for FY1819 was 79.0%.
- Eskom however achieved an AEF of only 69.95%, which was mainly driven by unavailability of the coal fleet as it accounts for the majority of Eskom generation capacity.

Open Cycle Turbine Use..3

- The MYPD decision limited the use of OCGT due to the high declared availability of the Eskom coal fleet for which Eskom is compensated via appropriate depreciation and return on assets allowed as part of the MYPD decision,
- These assets at the time of the approval were either to be used in generation of electricity or should have been available for use.
- The fact that Eskom had to make extensive use of OCGT was because of supply constraints on the part of Eskom rather than increased demand.
- Therefore, while it may have been prudent for Eskom to run the OCGTs excessively instead of shedding load, the excessive use was due to inefficiencies in Eskom management of its generation fleet.
- Allowing Eskom to claim OCGT use in excess of what was officially approved by NERSA will be tantamount to rewarding Eskom for its own operational inefficiencies twice.
- This is because Eskom during application phase declared availability of plant and as a result earning returns though such plant in real time turn out to be not available.

Nuclear fuel cost

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- Eskom overspent on Nuclear fuel cost by R269m, though this amounted to over expenditure it remains the most efficient form of fuel for electricity generation at approximately R0.07/kWh.
- Eskom should therefore be encouraged to maximize output from its Nuclear power station.

Other primary energy Cost

- Eskom was allowed other primary energy cost of R7 096m and spent R8 552m and therefore claimed an RCA balance of R1 456m in its favor.
- The actual expenditure on other primary energy cost was 27% higher when compared to that of the preceding financial year.
- This is despite the fact that demand for electricity dropped over the same period.
- Since other primary energy cost are essentially variable, a prudent and efficient Eskom should have achieved savings on this particular item.
- These cost should therefore not be allowed as Eskom management where clearly not prudent and efficient as required by law.

IPPs and Renewable IPPs

- Eskom was allowed Renewable IPP cost of R24 216m to procure 11 591GWh from it however incurred cost of R22 364m realizing a saving of R1 852m as the actual output from Renewable IPPs was only 10 792GWh.
- In procuring from renewable IPPs Eskom incurred penalty of R28.3m for not been able to dispatch IPP output due to its network conditions
- Eskom should not be allowed to recover the R28.3m from the customer as the peculiar network condition should have been avoided by the utility.
- The penalty of R28.3m was imposed after a formal dispute resolution process, NERSA should therefore compel Eskom to submit actual dispute resolution reports to determine prudency
- We recommend that this be disallowed as the Eskom application does not seem to provide substantive evidence of findings of the three cases subjected to formal dispute resolution processes.

DoE Peaking

- Eskom also spent R6.4m for curtailing IPP projects while they were able to generate electricity for duration of curtailment.
- Since this particular situation should have been avoided ,it would not be prudent for NERSA to compensate Eskom for its own operational inefficiencies.
- The R6.4m should also not be recovered from the customer as the curtailment should have been avoided.
- Eskom was allowed to generate only 88GWh from the DoE peaking plant,
- Based on the information provided as part of the Eskom RCA application it generated 552GWh from the peaking plant due to limited actual generation capacity of its own generating fleet.
- All expenditure in excess of the allowed expenditure should therefore be disallowed on the basis of lack of prudency on the part of Eskom.

Depreciation

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- Depreciation should not be allowed as the utility asset base is as determined by the regulator
- The only element that should be subjected to any form of risk adjustment in variation is qualifying allowed capex and actuals by the regulator.

DMP & EEDSM

- As per the application Eskom was allowed R290m for DMP projects none of which has been implemented, the entire R290m should therefore be returned to the customer.
- Eskom was not allowed any form of EEDSM and should therefore not be allowed to claim any from the customer

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Opex

- Except for offsetting other operating income, management of operating expenses should be within the allowed budget and remain the responsibility of Eskom management.
- Eskom should therefore not be allowed to recover any form of over expenditure from the customer.

Nuclear Decommission cost

- This cost element was known at the time of the Eskom revenue allocation and should be deemed to have been incorporated in the original Eskom application as well as the allowed cost for nuclear fuel.

Conclusion

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- Our analysis show that Eskom cannot be allowed the total amount it claims in this RCA
- We hope that NERSA consider the basis of our analysis and also further apply its regulatory prudency tests on this application
- Eskom's financial suitability is a course of concern for all but also the customers cannot be allowed to pay for costs that have not been prudently incurred

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