



DISCUSSION DOCUMENT

**GUIDELINES ON THE FINANCIAL PROVISION FOR REHABILITATION
OF LAND**

19 MAY 2020

Definitions:

'The Act' means the Petroleum Pipelines Act, 2003 (Act No. 60 of 2003).

'The Regulations' means the Regulations made under the Act.

'NEMA' means the National Environmental Management Act, 1998 (Act No.107 of 1998).

'Rehabilitation of Land' may be interpreted as restoring the land on which a licensed activity was located back to a sustainable and usable condition. This is guided by the concept of sustaining land use or preventing loss of land use through the protection of the environment and its biodiversity; and ensuring its sustainability for its beneficiaries.

'Abandonment' may mean leaving behind material/structures in situ at the end of life or expiration of the life of an asset. However, after the life of an asset has ended/expired, the facility must be recycled, relocated or safely disposed of in an environmentally friendly/acceptable manner.

'Decommissioning' is the step-by-step process of abandoning a licensed activity, which needs to be planned at the beginning of the life of the asset, because it consists of cost-intensive matters such as:

- the removal of petroleum facilities;
- the disposal of petroleum facilities;
- the obligation to pay for removal and disposal; and
- managing residual risks.

'Moth-balling' involves the cessation of licensed activity and the preservation of its associated infrastructure for possible future use or sale.

List of Acronyms

| | |
|---------------------|--|
| NERSA | National Energy Regulator of South Africa |
| The Guidelines | Guidelines for Financial Provisioning for Rehabilitation of Land |
| DMRE | Department of Mineral Resources and Energy |
| DEA | Department of Environmental Affairs |
| EIA | Environmental Impact Assessment |
| The EIA Regulations | Environmental Impact Assessment Regulations |
| HSE | Health, Safety and Environment |
| PPE | Property, Plant, Vehicles and Equipment |

INTRODUCTION

1. The National Energy Regulator of South Africa (NERSA) is a regulatory authority established as a juristic person in terms of section 3 of the National Energy Regulator Act, 2004 (Act No. 40 of 2004) ('the NERSA Act'). The Energy Regulator's mandate is to regulate the electricity, piped-gas and petroleum pipelines industries in terms of the Electricity Regulation Act, 2006 (Act No. 4 of 2006) ('the ERA), Gas Act, 2001 (Act No. 48 of 2001) ('the Gas Act') and Petroleum Pipelines Act, 2003 (Act No. 60 of 2003) ('the Act').
2. NERSA is embarking on a process of developing Guidelines for Financial Provisioning for Rehabilitation of Land ('the Guidelines'). The Guidelines will:
 - a) guide licensees in establishing acceptable financial security to set aside funds for the rehabilitation of land used in connection with the licensed activity; and
 - b) provide clarity to licensees with reference to legislation and regulatory framework on how financial provision for rehabilitation of land and decommissioning of licensed petroleum infrastructure will be evaluated and recovered through tariffs.
3. This Discussion Document aims to solicit stakeholder comments to develop robust, clear and binding Guidelines.
4. Although the Energy Regulator will develop and use the Guidelines to assess the financial security selected by licensees, the Energy Regulator will always exercise its discretion when dealing with matters relating to rehabilitation of land or the decommissioning of the petroleum infrastructure it regulates.
5. The Discussion Document also covers the legal framework as prescribed by regulation 9 of the Regulations made in terms of the Act ('the Regulations'), focusing on the regulations pertaining to the financial provision for prospecting, exploration, mining or production operations, as prescribed by the National Environmental Management Act, 1998 (Act No. 107 of 1998) ('NEMA'), as well as, the information emanating from other consultations by NERSA.

LEGAL BASIS

6. In terms of section 2(c) of the Act, the Energy Regulator '**must** ensure the safe, efficient, economic and **environmentally** responsible transport, loading and storage of petroleum'. To achieve this, it is required that licensees who apply for a licence to construct or operate petroleum pipeline, loading and storage facilities, include the plans and the ability of the licensee to comply with the applicable labour, health, safety and environmental legislation as entrenched in section 16(2)(f) of the Act.

7. Section 27 of the Act further stipulates that:
*the Energy Regulator **may** require the licensee to submit financial security, or make such other arrangements as may be acceptable to the Energy Regulator, to ensure compliance with any licence condition relating to health, safety, security or the environment, prior to, during or after the period of validity of the licence*
8. Furthermore, regulation 9 of the Regulations made under the Act prescribes that:
- (1) *A licensee must inform the Energy Regulator in writing when it applies to the relevant environmental authority for an environmental impact assessment for the termination of or abandonment of the licensed activity in accordance with the NEMA.*
 - (2) *A Licensee must, at least six months prior to termination or abandonment of a licensed activity, submit to the Authority, proof of the approval of the termination or abandonment of the licensed activity.*
 - (3) *The Authority must require the licensee to provide financial security or make arrangements as may be acceptable to the Authority for purposes of rehabilitating the land used in connection with a licensed activity.*
 - (4) *The Financial security contemplated in sub-regulation 3 may be in any form acceptable to the Authority and may only be used with the approval of the Authority.*
 - (5) *The Authority may, in writing, at any time, require written confirmation from a licensee that it is in compliance with the requirements of the NEMA.*
 - (6) *The Authority may require written proof from the licensee that the authority responsible for administering the NEMA has approved the environmental impact assessment required by the Act.*
 - (7) *The Authority may not revoke the licence in respect of a licensed activity, before it is in receipt of a certificate from an independent consultant competent to conduct environmental impact assessments in accordance with the NEMA, which states that the site has been rehabilitated.*
9. Regulation 4(2)(c) also states that ‘the tariffs set by the Authority must enable an efficient licensee to rehabilitate land used in connection with a licensed activity’.
10. In accordance with the operation licence, licensees are also required to comply with the provisions of regulation 9 regarding the financial provision for land rehabilitation as a condition of the licences.

Problem Statement

11. As mentioned above, the Energy Regulator must ensure that licensees comply with the requirements of regulation 9. The following are some of the key concerns, in respect of the financial provision for rehabilitation of land by licensees:
- (a) Most licensees do not have financial securities to cater for the rehabilitation of land that have been approved by NERSA;
 - (b) Most licensees do not include a provision for rehabilitation of land in the determination of tariffs to be set or approved by NERSA.
 - (c) The criteria used by NERSA to assess acceptable financial security is not clear to licensees;

- (d) It is difficult for licensees to include the scope and costs of the rehabilitation of land during the operation phase; and
 - (e) The “Trust”, a financial security that passed the test in terms of the criteria, is considered burdensome by licensees. The criteria used was that the financial security should be a liquid instrument; should be dedicated specifically for the use of the rehabilitation of land; should be ring-fenced; and the funds should be kept in an interest-bearing instrument that out passes inflation.
12. The Act and the Regulations are silent on what constitutes ‘financial security’ or ‘acceptable arrangements’. What is clear, as provided for in section 27 of the Act, is that the Energy Regulator may require the licensee to submit financial security, or make such other arrangements as may be acceptable to the Energy Regulator, to ensure compliance with any licence condition relating to health, safety, security or the environment, prior to, during or after the period of validity of the licence.
13. NERSA interprets financial security as a vehicle/instrument that will ensure that funds are available to cover all costs related to the decommissioning (closure, dismantling and disposal/removal of assets) and rehabilitation of land used in connection with the licensed activity. The financial security selected by licensees must ensure that:
- (a) funds are available at the end of the useful life of the assets relating to the licensed activity;
 - (b) funds are protected from creditors and normal operational funding needs of the business;
 - (c) in the event of change of ownership (whether the licensee had a third party or not), funds set aside for purposes of rehabilitation of land must be transferred to the new owner, after obtaining approval from the Energy Regulator; and
 - (d) funds may only be used with the approval of the Energy Regulator.
14. It should be noted that it is NERSA’s interpretation that the Regulations imply provision for funding for decommissioning. Funding and provisions for rehabilitation during the operational phase of the licensed activity (e.g. incidents like accidental damage, integrity failures/spillage from operational problems or criminal activities) are dealt with in terms of Environmental legislation.

CONSULTATIONS WITH KEY STAKEHOLDERS

National Environmental Management Act (NEMA) Requirements – DMRE/DEA

15. The Department of Mineral Resources and Energy (DMRE) is responsible for the gazetting of the Petroleum Pipelines Regulations, which includes provisions for rehabilitation of land associated with activities licensed in terms of the Act and the NEMA requirements.
16. During consultation with key stakeholders on the rehabilitation of land, NERSA engaged with the DMRE on relevant matters. The DMRE highlighted that the financial provision in the National Energy Act, 2008 (Act No. 34 of 2008) was introduced to

ensure that in the event that licence holders prematurely cease to operate the facilities, for reasons such as liquidation, the country is not exposed to any risks. It also ensures that the country does not inherit any liability in this regard.

17. According to the DMRE, the licence holder can be granted different rights such as mining rights, prospecting rights and/or a mining permit. However, each licence holder is required to provide the DMRE with the financial security vehicle of choice prior to the licence holder being granted rights by the DMRE.
18. The financial security/instruments that are currently accepted by the DMRE are as follows:
 - a) The DMRE Rehabilitation Trust is established in terms of the income tax registration and also registered with the Deeds Office, of which the DMRE is a beneficiary. Licensees are required to submit information relating to their contributions to the Trust to the DMRE annually.
 - b) A financial guarantee from either the bank or an insurance policy both qualify as financial guarantees according to the DMRE.
19. There is a difference between a guarantee from a bank and one from an insurance policy. A bank would normally require licensees to have funds available that are equivalent to the guarantee, which the licensee will set aside for that purpose, while funds from insurance will accumulate from the premiums paid monthly. The DMRE considers these vehicles the same, as it will still be a beneficiary and be entitled to the full amount of the financial security when it is due.
20. It is worth noting that the DMRE administers the abovementioned accounts. Any lapses and/or cancellations in payments are communicated by the institutions to the DMRE being the beneficiary. The amount is then deposited into a separate account held by the DMRE (the DMRE Rehabilitation Trust Account). Withdrawals will be made through the DMRE's authorisation, should it be required. The withdrawals have to be for the purpose the funds are intended for, namely land rehabilitation.

The Department of Environmental Affairs (DEA)

21. The DEA indicated that although regulation 9(1) made under Act states that 'a licensee must inform the Energy Regulator in writing when it applies to the relevant environmental authority for an Environmental Impact Assessment (EIA) for the termination of or abandonment of the licensed activity in accordance with the NEMA', the NEMA does not require an EIA to be done for the termination or abandonment of all the licensed activity, but rather for those listed and specified activities under the EIA Regulations, 2014 ('the EIA Regulations'), which may be triggered as a result of the termination or abandonment of the licensed activity.
22. The DEA stated that the EIA Regulations, in its three (3) listing notices, identify listed and specified activities that may be triggered by a development. Depending on the activity, the requirement can be met by following one of the prescribed processes i.e.

the basic assessment or the scoping and environmental reporting process. The following are some of the activities that require basic assessment¹:

- a) the development and expansion of facilities or infrastructure for the storage and handling of dangerous goods² where such storage occurs in containers with a combined capacity of 80 to 500 cubic meters;
- b) the expansion and related operation of facilities and infrastructure for the bulk transportation of dangerous goods in liquid form, outside an industrial complex or zone, by an increased throughput capacity of 50 cubic meters or more per day; and
- c) the decommissioning of existing facilities, structure or infrastructure for any development and related operation of any of the listed activities.

23. Where such activity is triggered, the relevant process, such as the Basic Assessment of Scoping and Environmental Impact Report, must be followed. According to the DEA, it is imperative that all three listing notices are carefully considered to ensure that any potential listed or specified activity is identified and assessed accordingly. Wherein the proposed termination or abandonment of the licensed activity relates to decommissioning, activity 31 of listing notice 1 under the EIA Regulations may be triggered. Activity 31 deals with the decommissioning of existing facilities, structures or infrastructure for:

- (a) *any development and related operation activity or activities listed in this Notice, Listing Notice 2 of 2014 or Listing Notice 3 of 2014;*
- (b) *any expansion and related operation activity or activities listed in this Notice, Listing Notice 2 of 2014 or Listing Notice 3 of 2014;*
- (c) *any phased activity or activities for development and related operation activity or expansion or related operation activities listed in this Notice or Listing Notice 3 of 2014; and*
- (d) *any activity regardless the time the activity was commenced with, where such activity is similarly listed to an activity in (i) or (ii) above and is still in operation or development is still in progress.*

24. In conclusion, the DEA indicated that the EIA Regulations do not require the provision of funds related to rehabilitation, but only requires an application fee for lodging an environmental authorisation. The fee is purely for administrative purposes. However, the provision of funds becomes a requirement in terms of the Financial Provisioning Regulations, 2015, published under the NEMA, for the costs associated with the undertaking of management, rehabilitation and remediation of environmental impacts from prospecting, exploration, mining or production operations through the lifespan of such operations and latent or residual environmental impacts that may become known in the future.

25. Based on the above information from the DEA, licensees are required to report to the NEMA and to the Energy Regulator regarding environmental issues.

¹ Environmental Impact Assessment Regulations Listing Notice 1 of 2014 (No. R 983 in GG No. 38282 of 4 December 2014)

² Listed as such in the South African National Standard No. 10234 (referenced in the definition of 'dangerous goods' in the Environmental Impact Assessment Regulations)

Request for comment 1:

- a) Comment on the stance, interpretation and implementation of the framework and the position of the NEMA regarding the financial provision for rehabilitation of land; in particular the rehabilitation of land or decommissioning of petroleum infrastructure.

Financial Institutions

26. As part of the consultation process, NERSA consulted financial institutions on the type of financial instruments that can be offered to licensees.
27. The financial institutions identified two key financial instruments that can be used by licensees, namely:
- a) an escrow account; and
 - b) a guarantee structure.

Escrow Account

28. An escrow structure is a risk mitigation tool for trading parties. It is a contractual agreement between the Depositing Party, Receiving Party and an Escrow Agent. It is designed to protect the interests of these parties against a change in ownership or title, and eliminate the uncertainty of non-performance by either party. Escrow accounts are used as a risk mitigation tool in a variety of other transactions and are tailored to meet the transactional requirements of both parties involved in the transaction.
29. An escrow account is a bank-controlled account governed by an escrow account agreement between the bank and the parties to the escrow account. Funds are deposited into the account and the funds are released or returned based on conditions specified in the underlying escrow agreement. The funds are released or returned upon presentation of a joint instruction signed off by all parties. Escrow is a legal concept which describes a financial instrument presented as an asset. Such escrow money is held by a third party on behalf of two other parties that are in an agreement and as such are in the process of completing a transaction. Escrow accounts often include escrow fees managed by agents who hold the funds or assets until receiving appropriate instructions for the predetermined contractual obligations to be fulfilled.
30. The escrow agent acts as an independent third party and custodian based on pre-agreed terms between all parties in the transaction. The following are the values offered by an escrow account:
- a) It mitigates the risks associated with certain financial transactions.

- b) The escrow structure provides an alternative solution to letters of credit and bank guarantees.
 - c) Parties are not required to have credit lines with a bank, nor a bank account with the bank acting as escrow agent. It might be suitable for smaller pipeline operators who do not have the financial standing to obtain credit facilities.
 - d) Clients can earn interest on funds deposited in escrow, depending on the tenor of funds deposited in escrow.
 - e) It is used by parties in instances where the requirement is to facilitate and ensure a safe flow of funds.
 - f) The escrow structure is cost-effective, where a series of similar transactions can occur over a period of time. It has potential cost savings relative to other risk mitigation instruments such as letters of credit and guarantees.
 - g) It facilitates the practice of good governance principles.
 - h) The funds held in escrow can be paid out to NERSA in the event of default of obligations by the pipeline operator, or paid to the operator with NERSA's consent, in order for the pipeline operator to fulfil their rehabilitation obligations.
 - i) The escrow account provides a flexible way for the provisions held under escrow to increase on a monthly basis in line with tariff contributions.
31. As indicated above, the escrow account operates with three parties: namely the depositing party, the receiving party and the escrow agent. The process is initiated by the two transacting parties signing an agreement, stipulating the terms and conditions up front, and ends with the agent releasing the funds as per the agreed release instruction received. The transaction can be once off or can involve revolving payment dates.
32. The agent acts independently of the transaction and securely receives, monitors and manages cash or documents – the agent holds funds in escrow on behalf of the transacting parties, until such time that all conditions of the escrow arrangement are met.
33. Using an escrow structure provides comfort and convenience to both parties. Funds are deposited in advance and will only be released once all pre-determined conditions have been met by the parties involved. In the event of sub-investment downgrades, there is no erosion of value, where Trust funds would have been invested through government bonds.

Guarantees

34. A guarantee is a written undertaking issued by a bank in favour of the beneficiary, wherein the issuing bank pledges to make certain payments on behalf of its client (applicant), if the latter fails to make a payment or perform in accordance with the terms of the commercial contract between the applicant and beneficiary.
35. The bank guarantee is a suitable financial instrument to the petroleum industry in line with the arguments below:

- a) In the event where the pipeline operator does not fulfil their rehabilitation obligations, NERSA will be able to engage the institution to withdraw the funds.
- b) The guarantee value can be adjusted up or down in line with the environmental liability, based on instructions from the pipeline operator and NERSA.
- c) The guarantee might, however, not be suitable for smaller pipeline operators as the bank would only consider providing credit facilities for clients with a sound financial standing or against the provision of cash collateral.
- d) Guarantee wording should be negotiated with the banking industry prior to finalisation of the required formats, to ensure alignment and support from guarantee providers and licensees.

Request for comment 2:

- a) Comment on whether the proposed instruments can be used as vehicles/instruments for the financial provision for decommissioning of licensed petroleum infrastructure, in particular the rehabilitation of land. Highlight their pros and cons as well as your preferred instrument with reasons.
- b) What other financial instruments could be considered for the financial provisioning for decommissioning of licensed petroleum infrastructure, including rehabilitation of land if required; and why you deem them better options, in case you do?

NERSA Licensees

- 36. During the 2018/19 financial year, as part of monitoring licensees' compliance with the licence conditions issued, NERSA requested information from licensees on how they make financial provisions for the rehabilitation of land.
- 37. The responses received are summarised as follows:
 - a) **Lump sum** – Some licensees indicated that they ensure that sufficient financial resources are available to rehabilitate the site upon closure.
 - b) **Insurance** – Some licensees indicated that they have insurance policies to cater for the environmental liability, which is insured against 'all past, present and future activities, functions, terminals, warehousing'.
 - c) **Bank Guarantees** – Some indicated that they have bank guarantees in place for financial provision for land rehabilitation.
 - d) **Trust** – One licensee has a Trust that was approved by NERSA as a suitable financial instrument to set aside funds for land rehabilitation purposes.
- 38. During consultations on the review of the methodology for petroleum storage and loading facilities in the 2019/20 financial year, stakeholders were also requested to present their views on financial provision for decommissioning of licensed activities, including rehabilitation of land. Stakeholders expressed divergent views regarding financial provision for land rehabilitation. Some argued that such a provision does not

serve a meaningful purpose in tariff calculations in the absence of third parties to storage facilities with no real recovery of funds as contemplated by the Energy Regulator. They argued that such financial provision ought to be capitalised, while the unwinding portion of the decommissioning fund is embedded as a separate component in the tariff formula and not necessarily under the operating expenses.

39. Other stakeholders indicated that they do not show financial provision for land rehabilitation as part of their operating costs in tariff applications. They indicated that they show it in their balance sheets as part of their fixed assets (decommissioning and removal) and it also reflects in the Health, Safety and Environment (HSE) provision as rehabilitation.
40. Table 1 below presents different kinds of financial instruments previously assessed by NERSA for suitability. It should be noted that NERSA only approved the Trust as an acceptable instrument as it was considered adequate in line with the current criteria for assessing financial security.

Table 1: Financial Instruments

| Financial Instrument | Description |
|-----------------------------|--|
| Fixed deposit | <ul style="list-style-type: none"> • Funds are not readily available because notice needs to be given. Availability of funds is dependent on the agreements between licensees and banks. • There is no guarantee that the funds would be used specifically for land rehabilitation. • The fixed deposit term might not be the same as the remaining life of the assets. • The fund does not yield a return in excess of inflation and is not protected from creditors. |
| Bank guarantee | <ul style="list-style-type: none"> • The beneficiary of the guarantee should not be NERSA. • Funds are readily available. • Funds are ring-fenced specifically for land rehabilitation. • The bank guarantee years might not be aligned with the remaining life of the assets. • It is protected from inflation and creditors. • It is an upfront payment. |
| Trust | <ul style="list-style-type: none"> • Funds are readily available for rehabilitation of land. • It is protected from inflation and creditors. • It is dedicated specifically for the use of the rehabilitation of land only. |
| Insurance | <ul style="list-style-type: none"> • Funds are not ring-fenced specifically for rehabilitation. • It is not protected from inflation and creditors. • It is not dedicated specifically for the use of rehabilitation of land. • It is not readily available because it depends on the outcome of the investigation. |

Instrument approved by NERSA

41. The regulatory precedence has been that licensees utilise trust accounts as acceptable financial securities. However, during stakeholder consultations on the review of the tariff methodology for petroleum storage and loading facilities, there is a view that trust

funds might not be a reasonable financial security for financial provision due to the following reasons:

- a) Significant expenses are incurred by the Trust, which results in a reduction of the funds set aside for land rehabilitation.
- b) Licensees have experienced complications regarding accounting and tax treatment of the contributions received by the Trust. For instance, the manner in which such contributions are accounted for in the Trust's financial records. Licensees have argued that as state-owned enterprises must adhere to the Public Finance Management Act, 1999 (Act No. 1 of 1999) ('PFMA'), they are not sure how to separate the financial records of the Trust from those of the main enterprise.
- c) The Trust is taxed at 45% which is significantly higher than the company tax at 28%. Hence, the contributions received by the Trust attract a higher tax rate than would have been the case had they been received by the licensee. This results in the depletion of the funds set aside for land rehabilitation.
- d) In compliance with the Trust Property Control Act, 1998 (Act No. 57 of 1998), the PFMA and other statutes, Trust accounts are a financial and administrative burden to the licensees.
- e) The Trust must invest in nominal and inflation linked bonds. Licensees are expected to conduct audits on these financial instruments in compliance with IFRS 9, which is complex and sophisticated.

The Financial Security Criteria

42. In terms of regulation 9(4) of the Regulations 'the financial security may be in any form acceptable to the Authority'. As such, the Energy Regulator does not prescribe the financial security, but requires that the financial security chosen by the licensees meet the following criteria:
 - a) **Liquid instruments:** The funds should be available within a reasonably short period of time when required.
 - b) **Dedicated instruments:** The funds should be placed in an instrument dedicated specifically for use in the rehabilitation of land.
 - c) **Ring-fenced instrument:** Irrespective of the governance structures (current and future) within or outside of the licensees, the funds should only be made available for the rehabilitation of land and must be protected against Licensees' creditors.
 - d) **Interest bearing:** The funds should be kept in an interest bearing instrument that outpaces inflation.
43. NERSA considers a financial security that provides assurance that the funds set aside cannot be accessed by creditors, nor utilised for any other normal operational funding needs of the business, as the most appropriate financial security. The strength of these financial instruments depends entirely on the investment platforms used. The money market is likely not a conducive platform.
44. In other regulated industries, for instance the Piped-Gas industry as stipulated through the Regulations made in terms of the Gas Act, financial provision for land rehabilitation may include an insurance policy, a bank guarantee, a trust fund, or any other financial

arrangement acceptable to the Energy Regulator. It is a requirement by the Energy Regulator that licensees may not terminate such financial security before it is in receipt of a certificate from an independent consultant able to conduct EIAs in accordance with the provisions of the NEMA, confirming the rehabilitation of the site on which the licensed activity was conducted.

45. A bank guarantee is potentially a fragile instrument, as it may lapse if bank fees are not paid or it can be problematic if the banks are not comfortable with the wording used in satisfying the Energy Regulator, which may transgress the interests of banking institutions. Therefore, escrow accounts are the Energy Regulator's financial instruments of choice. Fixed bank deposits may not beat inflation, especially when the economy is facing recessionary pressures; they are also not protected against creditor claims, as they are owned by licensees.
46. Relying on provisions in financial records of licensees or holding companies pose challenges in that they are kept in line with inflation if the value is set by accounting policies, and they are susceptible to manipulations by management at any time. The Energy Regulator cannot influence the financial policies and records of licensees.
47. Insurance policies are weak financial instruments as their strength is entirely dependent on how they have been worded, unless the policy explicitly states that it will allow a pay-out only if NERSA approves that the funds be used for the rehabilitation of land. However, if monthly premiums are not paid, the policy lapses.
48. The Energy Regulator has noted divergent views regarding rehabilitation of land and so far, maintains the regulatory precedence. However, there should be flexibility in terms of whether tariff applicants may capture financial provision for land rehabilitation as part of their capital or operational expenditure.

CANCELLATION, WITHDRAWAL AND CLAIMING AGAINST A FINANCIAL INSTRUMENT

49. In the event that the licensee wishes to withdraw its funds, the licensee must, in accordance with rule 12(6) of the Rules made in terms of section 33(3) of the Act, submit an application to NERSA at least six months prior to the date on which the funds are to be withdrawn, should the application be approved.

CALCULATION OF THE FINANCIAL PROVISION FOR DECOMMISSIONING OF LICENSED ACTIVITIES

50. The funds set aside for decommissioning, including land rehabilitation, are generally recovered through the tariffs. The land rehabilitation costs are recovered as part of the Operational Expenditure (OPEX) due to the fact that the land rehabilitation costs cannot earn a return under the Regulatory Asset Base (RAB). The mechanism that is

currently available to calculate the land rehabilitation costs is the present value of the future liability, less the value of funds in the 'decommissioning fund' to arrive at a balance still to be collected. The remaining balance is then divided by the remaining years to decommission the asset.

51. The following formula is applied to determine the land rehabilitation cost to be recovered through the tariffs:

$$PMT = [PV_{\text{fund value}}]/n$$

Where:

- N = the number of remaining years to decommission
 PV_{fund value} = the present value of decommissioning costs
 Fund value = the current balance in the decommissioning fund, being historic contributions (provision for decommissioning costs) plus net returns on such contributions.

52. Table 2 provides an example of how the land rehabilitation cost (included in tariff determination) is to be calculated. For the purpose of this example, the following assumptions were made:

- a) Estimated future value to decommissioned the asset R10 000
 b) Calculated present value R6 139
 c) Estimated useful life of the asset 10 years

Table 2: Calculation for land rehabilitation costs [for illustration purpose only]

| Details | Formular | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|--|------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Remaining Life | a | 10 | 9 | 8 | 7 | 6 | 5 | 4 | 3 | 2 | 1 |
| CPI | b | 5.00% | 6.00% | 4.00% | 4.00% | 6.00% | 7.00% | 8.00% | 5.00% | 4.00% | 5.00% |
| Net returns [after tax] in the fund | c | 6.00% | 7.00% | 5.00% | 4.00% | 6.00% | 7.00% | 8.00% | 4.00% | 4.00% | 5.00% |
| Present value of Land rehabilitation liability | d=opening* (1+b) | 6 139 | 6 507 | 6 768 | 7 038 | 7 461 | 7 983 | 8 622 | 9 053 | 9 415 | 9 886 |
| Fund value at beginning of the year | e=h | - | -632 | -1 352 | -2 114 | -2 916 | -3 871 | -4 993 | -6 336 | -7 513 | -8 784 |
| Still to be recovered over remaining life | f=(d+e) | 6 139 | 5 875 | 5 416 | 4 925 | 4 545 | 4 112 | 3 629 | 2 717 | 1 902 | 1 102 |
| To be recovered "this" year | g=(f/a) | 614 | 653 | 677 | 704 | 757 | 822 | 907 | 906 | 951 | 1 102 |
| Value of fund | | | | | | | | | | | |
| Opening Balance | h=k | - | 632 | 1 352 | 2 114 | 2 916 | 3 871 | 4 993 | 6 336 | 7 513 | 8 784 |
| Contribution from AR through the tariff | i=g | 614 | 653 | 677 | 704 | 757 | 822 | 907 | 906 | 951 | 1 102 |
| Net returns [after tax] in the fund | j=(h+i*50%)*b | 18 | 67 | 85 | 99 | 198 | 300 | 436 | 272 | 320 | |
| Closing Balance of fund | k=(h+i+j) | 632 | 1 352 | 2 114 | 2 916 | 3 871 | 4 993 | 6 336 | 7 513 | 8 784 | 9 886 |
| Liability less Fund value | l=(d-k) | 5 507 | 5 155 | 4 654 | 4 123 | 3 590 | 2 990 | 2 286 | 1 540 | 631 | - |

Request for comment 3:

- c) Stakeholders are requested to indicate whether the decommissioning costs, including rehabilitation of land, should be classified as OPEX or PPE and provide reasons for their answer.

Other comments

- d) Stakeholders are requested to provide any other comments on issues relating to the Guidelines on the Financial Provisioning for Land Rehabilitation that were not addressed elsewhere in this Discussion Document.

TIMELINES FOR PROCESSING THE GUIDELINES ON THE FINANCIAL PROVISION FOR REHABILITATION OF LAND

53. Table 3 shows the high-level projected administrative process that NERSA will undertake in processing the Guidelines on the Financial Provision for rehabilitation of land.

Table 3: Indicative timelines for processing Guidelines

| No. | Date | Action |
|-----|-------------------|---|
| 1. | 19 May 2020 | Petroleum Pipelines Subcommittee (PPS) approval of the Discussion Document on Guidelines on the Financial Provision for Rehabilitation of Land. |
| 2. | 28 May 2020 | Publish the Discussion Document on the NERSA website to solicit stakeholder comments. |
| 3. | 9 July 2020 | Closing date for comments on the Discussion Document. |
| 4. | 6 August 2020 | Public Hearing on the Guidelines for Financial Provision for Rehabilitation of Land . |
| 5. | 10 September 2020 | PPS meeting to recommend the Guidelines on the Financial Provision for Rehabilitation of Land for consideration by the Energy Regulator (ER). |
| 6. | 28 October 2020 | ER meeting to consider the Guidelines on the Financial Provision for Rehabilitation of Land . |

CONCLUSION

54. It is crucial that stakeholders present their views regarding what the Energy Regulator should approve as the most suitable financial instrument to cater for financial provisions for rehabilitation of land. Stakeholders are expected to present their views and attempt to answer the questions posed in this discussion document as part of their responses.
55. Members of the public are requested to submit written comments to:
Post: Attention – Head of Department (HOD): Petroleum Pipelines Tariffs
The National Energy Regulator of South Africa
PO Box 40343
Arcadia
Pretoria, 0007
Email: pipelines@nersa.org.za
Tel: 012 401 4102
Fax: 012 401 4700
56. The closing date for the submission of comments is close of business on **9 July 2020**.