

Annexure B

Supplementary Tariff Application

In accordance with High Court Judgement

Submission to NERSA

FY 2018/19

13 July 2020



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Preface

This supplementary tariff application is made to the National Energy Regulator of South Africa (NERSA) in accordance with the High Court judgement delivered on 10 March 2020.

After the NERSA revenue decision for the FY 2018/19 was made, the Eskom Board undertook to review the revenue decision corresponding to a 5.23% price increase, in the High Court. The founding affidavit was lodged in the High Court on 29 May 2018. The case was heard on the 27 and 28 January 2020. Judgement was delivered on 10 March 2020. The Judgement on this review stands.

The High Court order allows for Eskom to apply to NERSA to make a supplementary tariff determination application. This supplementary tariff determination will allow for expended costs to which Eskom would have been entitled to in the original revenue determination had the revenue decision been made lawfully. It is clarified that the Court Judgement refers to a tariff application. **However, in essence of this supplementary application is a revenue application.** This supplementary revenue application was required to be made within 60 days of the NERSA regulatory clearing account (RCA) decision being made. NERSA made its decision on 14 May 2020. Eskom was notified of the decision on 15 May 2020.

The judgement allows for Eskom to make a supplementary revenue application. This application to NERSA serves to meet this requirement.

Executive Summary

This supplementary revenue application is being made to NERSA in accordance with the order delivered by the High Court in relation to the FY 2018/19 revenue determination made by NERSA.

After the NERSA revenue decision for the FY 2018/19 was made, the Eskom Board undertook to review the revenue decision corresponding to a 5.23% price increase, in the High Court. The founding affidavit was lodged in the High Court on 29 May 2018. The case was heard on the 27 and 28 January 2020. Judgement was delivered on 10 March 2020. The Judgement on this review stands.

The High Court order allows for Eskom to apply to NERSA to make a supplementary tariff determination application. This supplementary tariff determination will allow for expended costs to which Eskom would have been entitled to, in the original revenue determination had the revenue decision been made lawfully. It is clarified that the Court Judgement refers to a tariff application. However, in essence of this supplementary application is a revenue application. This supplementary revenue application was required to be made within 60 days of the NERSA regulatory clearing account (RCA) decision being made. NERSA made its decision on 14 May 2020. The supplementary tariff application must be submitted by 13 July 2020.

It needs to be noted that the Court judgement was made after the completion of the financial year. Even though the High Court review of the NERSA revenue decision was based on projections, the applicable financial year, 2018/19, has passed. The **amounts expended** will be aligned with the actual amounts submitted in the RCA application, to the extent applicable. Eskom has already provided motivation for these expended costs in its RCA application. In addition, Eskom is required to ascertain the revenue that should have been determined by NERSA for FY 2018/19, had NERSA made the **decision lawfully**. In this instance, for the purposes of this supplementary tariff application, Eskom will refer to the revenue application made during August 2017. This serves to represent the efficient and prudent costs upon which basis NERSA's revenue determination should have been made, had the NERSA decision been made lawfully.

Due to the shortfall in the allowable revenue (related to decision not being made lawfully), Eskom was required to incur additional borrowing costs to address the shortfall in revenue. Thus the **carrying costs** are proposed to be included. Thus, once such additional revenue have been determined, the carrying costs are included. Only the interest cost, at a rate of 10% per annum compounded annually, is considered. The effect of inflation is not included.

TABLE 1: SUMMARY OF REVENUE IN SUPPLEMENTARY APPLICATION

Revenue Related Expended Cost Item	Revenue (R'm)
Coal costs	1 555
Independent Power Producer costs related to use of system (UOS)	101
Operating costs	2 425
Integrated Demand management costs	6
Sub Total	4 087
Carrying costs (assuming delay of 3 years) (with recovery in FY 2021/22) (At 10% interest per year, compounded annually)	1 353
Total	5 440

The amount of carrying costs assume that NERSA will allow the full additional revenue to be liquidated during Eskom's FY 2021/22. If liquidation is delayed beyond that year for whatever reason, there would be a concomitant increase in carrying costs.

1 Basis of Application

1.1 Court Judgement

1.1.1 Order

The order made by the North Gauteng High Court as delivered on 10 March 2020 for **case number 37296/2018**

1. The decision of the respondent (NERSA) in relation to the Eskom application for tariff increases for the 2018/19 year is reviewed and set aside.
2. Paragraph 1 of this order does not affect the validity of the tariff increase that was implemented by Eskom in respect of the 2018/19 tariff year.
3. Eskom is granted leave to apply to NERSA within 60 days of this Court's order or the final 2018/19 Regulatory Clearing Account (RCA) decision, whichever is the later, to make a supplementary tariff determination granting Eskom any additional amounts which it has expended in the 2018/19 tariff year and to which it would have been entitled had the original tariff decision been made lawfully, in accordance with the principles established by this Court's judgement in the matter under the above-mentioned case number.
4. Any additional amounts awarded by NERSA in terms of the process described in paragraph 3 above are to be added to the RCA balance and liquidated in accordance with additional tariff increases to be determined by NERSA in terms of the process contemplated by paragraph 3.
5. NERSA is to pay Eskom's costs in this application, including the costs of two counsel.

1.1.2 Status of the order and Judgement

NERSA has accepted the High Court Judgement. The order is implemented through this application to NERSA for a supplementary tariff determination.

1.1.3 Amounts expended

Eskom is allowed to apply to NERSA to make a supplementary tariff determination granting Eskom any additional amounts which it has expended in the 2018/19 tariff year and to which it would have been entitled had the original tariff decision been made lawfully.

It needs to be noted that the Court judgement was made after the completion of the financial year. Thus even though the High Court review of the NERSA revenue decision was based on

projections, the applicable financial year, 2018/19, has passed. The Court has judged that the supplementary tariff determination will be to grant Eskom any additional amounts which it has expended in FY 2018/19 and to which it would have been entitled had NERSA made the FY 2018/19 revenue decision lawfully.

The amounts expended will be aligned with the actual amounts submitted in the RCA application, to the extent applicable. In this supplementary tariff application, it is necessitated to consider the amounts expended, which are the actuals as at the end of FY 2018/19. These actual expended amounts are reflected in Eskom's Regulatory Clearing Account (RCA) application. Eskom has already provided motivation for these expended costs in its RCA application. The details of these revenue variances have been consulted on, during the RCA consultation process undertaken by NERSA between December 2019 and February 2020. Stakeholders were allowed to make written comments and participate in the public hearings held in most South African provinces.

1.1.4 Lawful decision

Eskom is required to ascertain the revenue that should have been determined by NERSA for FY 2018/19, had NERSA made the decision lawfully. In this instance, for the purposes of this supplementary tariff application, Eskom will refer to the revenue application made during August 2017. This serves to represent the efficient and prudent cost upon which basis NERSA's revenue determination should have been made, had the NERSA decision been made lawfully. It reflects the revenue related to prudent and efficient costs in accordance with the relevant legislation, regulatory rules, codes and regulatory guidelines. These include the Electricity Regulation Act, the Multi-Year Price Determination Methodology, and Cost Recovery for Power Purchases and the Guidelines for Prudency Assessments. The revenue requirement related to the efficient and prudent costs have been motivated in the revenue application submitted to NERSA during August 2017. These revenue requirements have also been consulted on, during the NERSA consultation from September 2017 to November 2017. Stakeholders were allowed to make written comments and participate in the public hearings held in most South African provinces.

1.1.5 Recovery of carrying costs

The Judgement refers to a lawful decision being one that was made prior to FY 2018/19 for implementation from 1 April 2018. Due to the shortfall in the allowable revenue (related to decision not being made lawfully), Eskom was required to incur additional borrowing costs to address the shortfall in revenue. It is acknowledged that additional revenue for the recovery of prudent and efficient costs, as determined by NERSA in the RCA determination does not

cater for carrying costs in the form of time value of money. However, with regards to the High Court Judgement that accommodates additional revenue to which Eskom would have been entitled to recover expended costs, had the decision been made lawfully, the carrying costs will need to be included. Thus, once such additional revenue have been determined, the carrying costs are included. Only the interest cost, at a rate of 10% per annum compounded annually, is considered. The effect of inflation is not included.

1.1.6 NERSA supplementary tariff decision

It is expected that NERSA will make this supplementary tariff decision in accordance with the requirements of the High Court Judgement. The revenue related to the expended costs to which Eskom would have been entitled had the revenue decision been made lawfully, and not included in the RCA balance determination will be included in the supplementary revenue application. It is clarified that this supplementary revenue application is based on the same information as the original revenue application, adjusted where applicable to reflect actual expenditure lower than had been assumed for purposes of the original revenue application. Such lower actual expenditure was also the basis for Eskom's RCA application. NERSA has already consulted on both the revenue application and the RCA application. Once NERSA makes its determination, the additional revenue will be added to the RCA balance decision for liquidation.

1.1.7 Key principles

The key principles referred to in the Judgement include the following:

1.1.7.1 Application of reasonable judgement (Paragraph 70 of Judgement)

It is clarified that the application of reasonable judgement according to the MYPD methodology (section 4.3) is the manner in which NERSA applies the objective that requires the balancing of competing interests of specifically licensees and consumers. However, this does not allow NERSA to use its discretion as it pleases. When it applies this discretion it must consider the interest of both Eskom and the consumer. Thus when NERSA applies reasonable judgement it must demonstrate that it was reasonable and that the impact on Eskom, amongst others, was considered.

It is thus understood that this requires a level of demonstration of the balancing of the impact on consumers and Eskom. It does require a fair amount of analysis that is transparently shown in the reasons for decision, as to how it arrived at its revenue decision. Thus it could be interpreted that the Court does not accept that reasonable judgment regarding balancing of interests is demonstrated by NERSA asserting that it has determined a decision to be

reasonable and fair in terms of the object of the Electricity Regulation Act. Details on the balancing and impact on all parties needs to be demonstrated.

1.1.7.2 NERSA is required to apply its methodology (Paragraph 74)

In the event that NERSA decides to depart from its methodology it first needs to formally revise the methodology, which requires it to consult on this revised methodology. From an understanding of NERSA processes, this would require a process of review of the methodology. With regards to the MYPD methodology, NERSA did publish its revised methodology during October 2016. NERSA utilised this opportunity, in 2016, to make changes after undertaking a public participation process. Eskom had already started preparing its revenue application for the period starting 1 April 2018 at the time that the methodology was finalised. NERSA ensures that the application is compliant to the methodology prior to progressing further with its analysis and consultation.

It is understood that NERSA was required to adhere to the MYPD methodology (as published in 2016) when determining the allowable revenue for FY 2018/19. In addition, NERSA was in agreement that Eskom's revenue application (submitted to NERSA in August 2017) was compliant with the MYPD methodology and the Minimum Information Requirement for Tariff Application (MIRTA). Certain condonations were granted by NERSA in this regard.

1.1.7.3 Coal prices (Paragraph 79)

NERSA did not apply the formula applicable to coal costs in its MYPD methodology. The MYPD methodology states that the cost of coal will be escalated using the formula in the contract.

1.1.7.4 Regulatory Asset Base (Paragraph 82)

The MYPD methodology requires assets that are used and usable thus able to supply demand within twelve months to be included in the Regulatory Asset Base (RAB). This applies specifically to the Hendrina and Arnot Power Stations.

Thus it is required to include the Hendrina and Arnot power stations as well as related expended costs associated with the running of these power stations in this supplementary tariff application.

1.1.7.5 Employee costs (Paragraph 84)

NERSA did not apply reasonable judgement in the criteria it employed to determine optimal employee numbers. The application of the incorrect criteria is an arbitrary approach that does not consider the Eskom business model.

Thus it is required to consider the nature of the business model when determining the optimal number of employees. The actual expended costs associated with employees will be included in this supplementary tariff application made to NERSA.

1.1.7.6 Integrated Demand management (IDM) (Paragraph 86)

The MYPD Methodology requires Eskom to undertake IDM initiatives, specifically energy efficiency and demand side management (EEDSM) initiatives. This is independent of the level of capacity available. However, the NERSA decision disallowed all costs associated with EEDSM.

In response to the revenue decision and severely constrained financial situation, Eskom had to significantly curtail the continuation of any EEDSM programmes. It is evident from the actual expended amounts for this revenue item that Eskom was not able to expend as was required by the MYPD methodology. Eskom will thus not be in a position to include what was originally required in terms of the MYPD methodology in this supplementary tariff application and will limit the amount to what was actually expended.

1.1.7.7 Other revenue items (Paragraph 87)

Concerns were raised regarding revenue adjustments on other expended costs including transmission costs and double-counting errors. These adjustments are not determined to be due to unreasonable or irrational decision making. They could be addressed by NERSA in its RCA determination.

To the extent that these or any other expended amounts are not addressed by NERSA in the RCA determination, they would be included in this supplementary tariff application, to the degree that Eskom would have been entitled to the related revenue had NERSA's revenue decision been made lawfully.

1.1.8 Summary

NERSA's treatment of these items in the revenue decision were found to be procedurally unfair, irrational, unreasonable and unlawful.

1.2 Supplementary application to include expenditure to which Eskom would have been entitled, had NERSA's decision been made lawfully

The Judgement confirms that the Electricity Regulation Act (ERA) is the legislation that governs the determination of tariffs (is at the apex of the legal hierarchy). The Electricity Pricing Policy (EPP) is the policy instrument. The Multi-Year Price Determination Methodology

(MYPDM) sets out the methodology to be applied by NERSA in determining Eskom's tariffs. The EPP is subordinate to the ERA. The MYPDM is subordinate to both the ERA and the EPP.

Thus it is surmised that the lawful aspect referred to in the judgement implies the implementation of relevant aspects of the ERA. These include the following:

- Tariff principles where revenues must enable an efficient licensee to recover the full cost of its licensed activities, including a reasonable margin or return;
- One of the objectives of the ERA namely to facilitate a fair balance between the interests of customers, end users, licensees (in this case Eskom), investors and the public.

2 Summary of Applications and Determinations

2.1 Eskom Revenue Application for FY 2018/19

The following table summarises the revenue application made for the FY 2018/19 by Eskom during August 2017.

TABLE 2: ESKOM REVENUE APPLICATION FOR FY 2018/19

Allowable Revenue (R'millions)	AR	Formula	Application 2018/19
Regulated Asset Base (RAB)	RAB		763 589
WACC %	ROA	X	2.97%
Returns			22 690
Expenditure	E	+	62 221
Primary energy	PE	+	59 340
IPPs (local)	PE	+	34 209
International purchases	PE	+	3 216
Depreciation	D	+	29 140
IDM	I	+	511
Research & Development	R&D	+	193
Levies & Taxes	L&T	+	7 994
RCA	RCA	+	
Total Allowable Revenue	R'm		219 514

2.2 Updated information provided to NERSA during consultation process

In accordance with the MYPD methodology, Eskom provided NERSA with updated information closer to the time that the revenue determination was made. This was mainly related to the change in the projected volumes. This also results in changes in the production plan, which was provided to NERSA during November 2017. The table below summarises the key updates that were provided to NERSA.

TABLE 3: UPDATED INFORMATION PROVIDED TO NERSA RELATED TO FY 2018/19 REVENUE APPLICATION

Allowable Revenue	AR	Formula	Application FY 2018/19	Adjustments to Application	Updated Information FY 2018/19
Regulatory Asset Base (RAB)	RAB		763589		763589
WACC %	ROA	x	2,97%	0%	2,97%
Returns			22690	0	22690
Expenditure	E	+	62221	0	62221
Primary Energy	PE	+	59340	450	59790
IPP's (Local)	PE	+	34209	-7080	27129
International Purchases	PE	+	3216	0	3216
Depreciation	D	+	29140	0	29140
IDM	I	+	511	0	511
Research & Development	R&D	+	193	0	193
Levies & Taxes	L&T	+	7994	0	7994
RCA	RCA	+	0	0	-
Total Allowable Revenue	R'm		219514	-6630	212884

2.3 NERSA Revenue decision made for FY 2018/19

The summary of the NERSA revenue decision made for FY 2018/19 is reflected in the table below.

TABLE 4: NERSA REVENUE DECISION ON ESKOM'S ALLOWABLE REVENUE FOR FY 2018/19

Elements (Rmillion)	Eskom Application 2018/19	NERSA Adjustments	NERSA Decision 2018/19
Return	22 690	5 427	28 117
Expenditure	62 221	-11 099	51 122
Primary Energy	58 331	-10 777	47 554
Open Cycle Gas Turbines (OCGTs)	691	-346	345
Demand Market Participation (DMP)	319	-29	290
Independent Power Producers (local)	34 209	-7 613	26 596
International Purchases	3 216	-	3 216
Depreciation	29 140	-4 237	24 903
Integrated Demand Management (IDM)	511	-511	-
Research and Development	193	-81	112
Levies and Taxes	7 994	99	8 093
Total Allowed Revenues	219 515	-29 167	190 348

The table above illustrates the difference between the original revenue applications made by Eskom for FY 2018/19 and the decision made by NERSA.

2.4 Eskom's RCA application for the FY 2018/19

TABLE 5: SUMMARY OF ESKOM'S RCA APPLICATION

RCA for 2018/19	2018/19 Decision	2018/19 Actuals	Variance	RCA adjustments	2018/19 RCA
Total Revenue R million	190 348	179 892	10 456	(5 006)	5 450
Primary Energy , R million	86 094	99 489	13 395	3 392	16 786
Coal	39 177	49 903	10 726	1 689	12 416
Open Cycle Gas Turbines (OCGTs)	345	3 768	3 423	-	3 423
Other	782	-	(782)	-	(782)
Other primary energy	7 595	9 320	1 725	-	1 725
Independent Power Producers	26 596	24 952	(1 644)	1 369	(275)
International Purchases	3 216	3 740	524	-	524
Environmental levy	8 093	7 805	(288)	-	(288)
Demand Response (DR) - Instantaneous	110	-	(110)	110	-
Demand Response (DR) - Supplementary	162	-	(162)	162	-
Demand Response (DR) - Programme administration	18	-	(18)	62	44
Other costs	104 254	106 871	2 617	2 221	4 838
Depreciation	24 903	26 427	1 524	-	1 524
Return on Assets (ROA)	28 117	28 107	(10)	-	(10)
Reserch & Development (R&D)	112	90	(22)	-	(22)
Demand Side Management (EEEDSM)	-	29	29	(2)	27
Operating costs	51 122	52 218	1 096	2 223	3 319
Service Quality Incentives (SQI)	-	166	166	-	166
FY 2019 RCA claim					27 240
Nuclear decommissioning from RCA 2013/14 decision phased in over 10 years					83
Total RCA balance					27 323

The table above reflects the variances between the NERSA determination for purposes of its revenue decision for FY 2018/19 and actuals that materialised (which is the amounts expended), as well as further adjustments to such variances, for items that are subject to the RCA determination.

2.5 NERSA Regulatory clearing account decision made for FY 2018/19

The summary of the NERSA regulatory clearing account decision made for FY 2018/19 is reflected in the table below.

TABLE 6: SUMMARY OF NERSA RCA DECISION FOR FY 2018/19

R'm	Decision FY 2019	Actuals FY 2019	Variance	RCA Adjustment	Application FY 2018/19	NERSA Adjustment	NERSA Decision
Total Revenue Rm	190 348	179 892	10 456	(5 006)	5 451	(3 038)	2 413
Primary Energy , Rm	86 094	99 489	13 395	3 392	16 786	(5 339)	11 447
Coal	39 177	49 903	10 726	1 689	12 416	(1 554)	10 861
Open Cycle Gas Turbines (OCGTs)	345	3 768	3 423		3 423	(2 937)	486
Other	782		(782)		(782)	0	(782)
Other primary energy	7 595	9 320	1 725		1 725	(717)	1 008
Water usage and procurement	2 353	2 146	(207)		(207)	0	(207)
Start-up gas and oil (coal-fired)	2 122	3 741	1 619		1 619	(717)	902
Start-up gas and oil (gas-fired)	9	0	(9)		(9)	0	(9)
Coal handling	2 010	2 000	(10)		(10)	0	(10)
Water treatment	499	474	(25)		(25)	0	(25)
Nuclear	499	768	269		269	0	269
Fuel procurement	39	144	105		105	0	105
Sorbent usage	64	47	(17)		(17)	0	(17)
Independent Power Producers	26 596	24 952	(1 644)	1 369	(275)	(130)	(406)
International Purchases	3 216	3 740	524		524	0	524
Environmental levy	8 093	7 805	(288)		(288)	0	(288)
Demand Response (DR) – Instantaneous	110		(110)	110			
Demand Response (DR) - Supplementary	162		(162)	162	44	0	44
Demand Response (DR) – Programme administration	18		(18)	62			
Other costs	104 254	106 871	2 617	2 221	4 837	(5 510)	(672)
Depreciation	24 903	26 427	1 524	0	1 524	0	1 524
Return on Assets (ROA)	28 117	28 107	(10)	0	(10)	(3 077)	(3 087)
Research & Development (R&D)	112	90	(22)	0	(22)	0	(22)
Demand Side Management (EEEDSM)		29	29	(2)	27	(6)	21
Operating costs	51 122	52 218	1 096	2 223	3 318	(2 426)	893
Service Quality Incentives (SQI)		186	186	0	186	(186)	0
FY 2019 RCA Balance Application					27 259	(14 072)	13 188
Nuclear decommissioning from RCA FY 2013/14 decision phased in over 10 years					83	0	83
Total RCA balance					27 323	(14 072)	13 271

3 Revenue Related to Coal Costs

Application of Court Judgement Principle on Revenue Related to Coal Costs

3.1 Principle in the Court judgement

NERSA did not apply the formula applicable to coal costs in its MYPD methodology. The MYPD methodology states that the cost of coal will be escalated using the formula in the contract.

3.2 Requirements of MYPD methodology

The R/ton coal price and R/ton/km transport cost (rail and road) shall be escalated using the formula in the contracts.

3.3 Supplementary tariff application for coal costs

TABLE 7: SUPPLEMENTARY APPLICATION FOR COAL COSTS

Expended costs in addition to revenue decision (RCA application)	Recovered in RCA	Supplementary Application
R12 416m	R10 861m	R1 555m

The table above illustrates the shortfall in the revenue related to expended efficient and prudent costs in addition to the revenue decision being the RCA application amount made. A significant portion was recovered in the RCA determination made by NERSA. The difference is being included in this supplementary application.

4 Revenue Related to OCGT Fuel Costs

Application of Court Judgement Principle on Revenue Related to OCGT Fuel Cost

4.1 Principle in the Court judgement

To the extent that any other expended amounts are not addressed by NERSA in the RCA determination, they would be included in this supplementary tariff application. This is with the proviso that the requirements meet the conditions of the original NERSA revenue decision being made lawfully.

4.2 Requirements of MYPD methodology

Gas turbines are provided to operate during peak periods as well as emergency situations. Subject to the conditions set out in this Methodology, gas turbine generation cost will be allowed as a full pass-through cost, but limited to volumes allowed by the Energy Regulator, except where such use was necessary to ensure security of supply due to events outside of management control.

Capacity constraints shall be mitigated by gas turbine generation as a last resort. For avoidance of doubt, gas turbine generation should be employed before implementation of load shedding activities.

4.3 Supplementary tariff application

In accordance with the production plan that Eskom had developed at the time of the revenue application, it had assumed to require a 1% load factor for its OCGT plants. Thus even though the actual expended OCGT plants were utilised at a much higher load factor, this variance is not included in this supplementary application. For the decision to have been made lawfully, the allowable revenue will correspond to a 1% load factor for the plants. This level of revenue related to OCGT costs have been allowed in the RCA. Thus this caters for the revenue decision having been made lawfully had Eskom's revenue application in this instance been considered.

5 Revenue Related to Start-up Fuel and Gas Costs

Application of Court Judgement Principle on Revenue Related to Start-up Fuel and Gas Costs

5.1 Principle in the Court judgement

To the extent that any other expended amounts are not addressed by NERSA in the RCA determination, they would be included in this supplementary tariff application. This is with the proviso that the requirements meet the conditions of the NERSA revenue decision being made lawfully.

5.2 Requirements of MYPD methodology

Eskom must:

- determine the costs;
- demonstrate (detailed calculation) how the costs were determined; and
- provide the assumption considered when determining the costs.

5.3 Supplementary tariff application

At the time of the revenue application, Eskom had made assumptions on the volume and price of the start-up fuel and gas costs. The volume assumed in the Eskom revenue application has been adequately addressed in the RCA decision.

6 Independent Power Producer Costs

Application of Court Judgement Principle on Independent Power Producer Costs

6.1 Principle in the Court judgement

To the extent that any other expended amounts are not addressed by NERSA in the RCA determination, they would be included in this supplementary tariff application. This is with the proviso that the requirements meet the conditions of the NERSA revenue decision being made lawfully.

6.2 Requirements of MYPD methodology

Use-of-system charges incurred by the buyer in line with the PPA from IPPs will be allowed as a full pass-through cost.

6.3 Supplementary tariff application

TABLE 8: SUPPLEMENTARY APPLICATION RELATED TO USE OF SYSTEM COSTS

Expended use of system costs	Recovered in RCA	Supplementary Application
R101m	0	R101m

In its RCA application, Eskom had applied for R101m efficient and prudent variance in its IPP costs related to the “use of system” expended costs. NERSA, did not allow for this efficient and prudence variance to be recovered in the RCA determination.

7 Operating Costs

Application of Court Judgement Principle on Operating Costs

7.1 Principle in the Court judgement

NERSA did not apply reasonable judgement in the criteria it employed to determine optimal employee numbers. The application of the incorrect criteria is an arbitrary approach that does not consider the Eskom business model.

Thus it is required to consider the nature of the business model when determining the optimal number of employees. The actual expended costs associated with employees will be included in this supplementary tariff application made to NERSA.

To the extent that any other expended amounts are not addressed by NERSA in the RCA determination, they would be included in this supplementary tariff application. This is with the proviso that requirements meet conditions of NERSA revenue decision being made lawfully.

7.2 Requirements of MYPD methodology

- Allowable expenses relate to all expenses that are incurred in the production and supply of electricity. These costs include normal operating expenditures, maintenance (excluding refurbishment costs that must be capitalised), manpower or labour costs, and overheads (centrally administrative and general expenses allocated) that are normally recovered within one financial year.
- Manpower costs should be allowed in accordance with the allowable revenue; any additional expenses over and above what was allowed will be at Eskom's expense, excluding inflationary charges
- Allowance for the human resources costs should be at reasonable levels. The Energy Regulator may require access to wage settlement documents to verify the reasonability of these costs.
- Expenses must be prudently and efficiently incurred and must be at arm's length transactions.
- Expenses must be incurred in the normal operations and supply of electricity, including an acceptable level of repairs and maintenance costs.
- Expenses forecast will be based on the most recent prudently and efficiently incurred actual costs taking into account the fixed and variable nature of such costs.

7.3 Supplementary tariff application

TABLE 9: SUPPLEMENTARY APPLICATION RELATED TO OPERATING COSTS

Expended costs in addition to revenue decision (RCA Application)	Recovered in RCA	Supplementary Application
R3 318m	R893m	R2 425m

Eskom's RCA application for operating costs reflects the expended costs that were not included in the revenue decision. A portion of these expended costs were recovered in the RCA determination. The remainder is included in this supplementary application.

8 Integrated Demand Management

Application of Court Judgement Principle on Integrated Demand Management

8.1 Principle in the Court judgement

The MYPD Methodology requires Eskom to undertake IDM initiatives, specifically energy efficiency and demand side management (EEDSM) initiatives. This is independent of the level of capacity available. However, the NERSA decision disallowed all costs associated with EEDSM.

8.2 Requirements of MYPD methodology

Eskom must develop and submit a five-year demand resource potential assessment including technical potential and estimated achievable potential. The five-year plan should be updated annually.

8.3 Supplementary tariff application

In response to the revenue decision and severely constrained financial situation, Eskom had to significantly curtail the continuation of any EEDSM programmes. It is evident from the actual expended amounts for this revenue item that Eskom was not able to expend as was required by the MYPD methodology. Eskom will thus not be in a position to include what was originally required in terms of the MYPD methodology in this supplementary tariff application and will limit the amount to what was actually expended.

Had the revenue decision been made lawfully, NERSA would have made a reasonable decision for allowing revenue related to EEDSM costs. Thus the R6m expended cost is included in this supplementary application.