OUTA
ORGANISATION UNDOING TAX ABUSE


7 March 2022

# OUTA submission to NERSA on Eskom’s RCA 2020/21 Application

**Submitted by:**
**Liz McDaid**
OUTA Parliamentary and Energy Advisor
liz.mcdaid@outa.co.za
087 170 0639

**TABLE OF CONTENTS**

**1. INTRODUCTION**

1.1 The Organisation Undoing Tax Abuse ("OUTA") is pleased to be considered as a valuable stakeholder in energy related matters that widely affect the public interest.

1.2 By way of introduction, OUTA is a proudly South African non-profit civil action organisation, comprising of and supported by people who are passionate about improving the prosperity of our nation. We envision a prosperous country, with an organised, engaged and empowered civil society that ensures responsible use of tax revenues.

1.3 Part and parcel to OUTA's mission is the challenging of legislation and regulatory environment, this includes participating and engaging with government on the Eskom Holdings SOC Ltd ("Eskom") Regulatory Clearing Account 2020/21 application ("RCA").

1.4 OUTA appreciates the opportunity to participate in the process, specifically as a representative of broader civil society. As you may be aware, OUTA has participated in the RCA processes in the past, the most recent being 2017 and 2018 respectively.

1.5 In the paragraphs below, OUTA will categorically illustrate its concerns, objections and suggestions. We wish to note that the majority of our contentions constitute a reiteration of issues raised in past, which unfortunately, to date, received little cognisance from NERSA.

## 2. CONTEXTUAL AND HISTORICAL BACKGROUND

2.1 If the RCA is mostly concerned with primary energy costs and costs that Eskom could not have predicted, this is the lens that NERSA has created to scrutinise any application for more money that Eskom could present. Critically, NERSA stated that only prudent and efficient costs will be allowed: *"Whether a cost is prudently incurred depends on how the decision to incur the cost was made, not the outcome of the decision."*[1]

2.2 Prudent action would mean that Eskom should be able to show how it has accounted for the changing context in which it operates and how, despite genuine attempts to do so, it has failed to generate the predicted revenue. It is our contention that Eskom fails dismally in this regard and accordingly should not be allowed any additional revenue but should meet its shortfall through other means.

2.3 We believe that Eskom has consistently failed to carry out its homework in predicting its demand, and therefore its revenue, and in its choice of energy supply, has failed to apply a consistent comparative method.

2.4 In reiteration of our previous contentions to Eskom's past RCA application, the following point should be noted:

2.4.1 The RCA process should be reviewed as it has outlived its usefulness. This process effectively allows Eskom to overstate its sales predictions and understate its operating costs, then go back to NERSA to get the extra funds.

[1] NERSA: August 2018. *Guidelines for Prudency Assessment*. Page 29. Available at http://www.nersa.org.za/Admin/Document/Editor/file/RegulatorsDecisions/Cross%20Cutting/Guidelines%20for%20Prudency%20Assessment-%20August%202018.pdf

2.4.2 Eskom routinely overstates its sales predictions. This is because Eskom does not pay attention to realities, where higher electricity prices and the increasing use by customers of embedded generation lowers the demand.

2.4.3 Eskom's cost calculations are questionable. The future of South Africa's economy depends on choices which Eskom makes. Costs incurred due to incorrect calculation of energy production costs cannot be passed through.

2.4.4 Medupi and Kusile have been years behind schedule and over budget, and are having problems, leaving Eskom with lower generation capacity than it should have plus higher costs for these power stations.

2.4.5 Staff costs still need attention but a focus on quality over quantity in terms of service delivery.

2.4.6 Eskom assumes that whatever prices it charges, customers will pay.

## 3. REPETITION OF THE SAME PATTERN, EXPECTING DIFFERENT RESULTS

3.1. Civil society returns year on year to present to NERSA on Eskom's RCA applications for yet another tariff increase. Unfortunately, the arguments presented by Eskom is nothing new and have been observed throughout the history of Eskom's past RCA applications.

3.2. In 2012, EGI-SA said this: "Interestingly, Eskom states in its MYPD3 application *that "Price is more effective at promoting investment into energy-efficiency technologies than incentive schemes or other factors. If price levels provide the correct signals, consumers will respond by limiting electricity use and employing more energy-efficient technologies, reducing demand*

3.3. In December 2014, Eskom failed to sell enough electricity to meet its revenue target. It was then allowed to raise electricity prices further in order to hopefully make enough money to make up the shortfall in revenue. This didn't work in 2009. It hasn't worked since. In Eskom's RCA 2020/21, they have returned with the same justification.

3.4. The following exerts from previous submissions ought to be noted as lessons that should have been learnt from 2013-2014 but seem not to be:

*"Eskom also underspent on its demand side management programmes and its energy efficiency programmes (R905m plus R316m (pg 22). However, given Eskom's past history, prudent operating would have not assumed 82 to 83% EAF, or new build commission that was over optimistic. And, if additional power had been saved through efficiency, less revenue would have been spent on expensive coal, diesel etc and thus it is difficult to see how these actions of Eskom are in any way "prudent".*

*The current overall methodology allows Eskom to regain revenue lost due to lower demand for electricity and lower economic growth. These trends are likely to continue, leading to a cycle of decreasing electricity sales and increasing electricity tariffs. It appears that there is a need to review the methodology as in its current state, there is no incentive for Eskom to apply its mind to solving the problem, as it can always rely on the RCA to bail it out.*

*The expensive diesel OCGT plants are running far more than anticipated at significant expense. In other words, Eskom failed to implement energy savings* *but still wants consumers to pay for its inability to implement electricity services in the most cost efficient way."*[2] This is still the case today.

3.5. OUTA has consistently made inputs which have reiterated the same recommendations over and over again. Our recommendations into the Eskom 2018/19 RCA included the following:[3]

3.5.1. A proper interpretation of the legal framework determining Eskom's cost recovery and NERSA's mandate shows that Eskom may only recover its costs and earn a return if it is "an efficient operator". It is patently no longer an efficient operator and NERSA therefore, in law, has no option but to deny Eskom any additional cost recovery until the enabling legislation is amended or until Eskom returns to being an efficient operator.

3.6. In OUTA's submission to NERSA on Eskom MYPD4, we made the following statement:[4]

*"OUTA is concerned about how will Eskom come out of this precarious situation of persistent "run-away" operational costs, huge debt which was R40bn in 2007 and currently at almost R400bn and expected to grow to over R600bn. This will require bold leadership and uncomfortable decisions taken to address the huge wage bill of R29.5bn as at March 2018. OUTA suggests that Eskom applies proposed World Bank Utility benchmark numbers."*

[2] SAFCEI in submission to NERSA re Eskom's RCA 2013-2014 application.

[3] See OUTA's submission on Eskom's 2018/19 RCA at page 3.

[4] See OUTA submission to NERSA re Eskom MYPD4.

*And further:*

*“However, OUTA’s concerns is that Eskom’s 15% per annum electricity price increase over the next three years is premised on desperate measures or attempts by Eskom to want to fix structural problems by throwing money at the problem rather than addressing or fixing the underlying root causes of diagnosed problems.”*

3.7. The above points are provided as part of a historical narrative. Civil society comments are on the record. The question is that with that history at hand, what makes up Eskom’s argument for this round of tariff increases? Eskom’s application seems to continue using the same justifications as it has used in previous years and it is difficult to see how the new methodology will reduce the runaway electricity tariff hikes.

## 4. ESKOM RESTRUCTURING

4.1. The RCA while riddled with some of the same historical logic as previous RCAs has been approached with the Eskom unbundling in mind. This has allowed far more transparency in the generation, transmission and distribution divisions.

## 5. ESKOM’S 2020/21 RCA REPEATS REVENUE PROBLEM

5.1. This RCA needs to be informed by the various reviews of previous RCA decisions s that is currently underway. “ The Eskom Board had successfully reviewed the RCA decisions for the 2015, 2016 and 2017 financial years through the High Court due to various reasons including the non-adherence to the MYPD methodology and NERSA regulatory principles such as consistency and predictability. NERSA had originally opposed this review application, but eventually withdrew its opposition. The outcome of the Judgement related to this case is also used as the basis of this RCA application. NERSA made a remittal decision on the three RCAs. However, this decision is being re-reviewed due to Eskom's submission that the Court order and judgement was not considered in this remitted decision.

5.2. The Eskom Board has also reviewed the NERSA FY2018 RCA decision. NERSA has opposed the FY2018 RCA review application. The legal process is still underway. In addition, the Eskom Board has instituted a High Court review of FY2019 RCA decision. This review is in conjunction with the review of the supplementary tariff decision made by NERSA arising out of the original review of the FY2019 revenue determination. NERSA has not yet determined the FY2020 RCA balance decision. Eskom has submitted this application on 14 December 2020.". It is therefore likely that this RCA is likely to be one in a series of tariff increases due to Eskom/NERSA tariff disputes.

5.3. In this RCA for FY2021 is once again due to electricity sales not arising with covid related sales being 7.1TWh with a revenue of R8250'm. Eskom is therefore applying for a total R10 637'm plus a nuclear decommissioning amount of R83'm.

See Table 1 below:

*Table 1: Summary of 2021 RCA application*

**Table 1: Summary of 2021 RCA Application**

| RCA for FY2021 | Decision FY2021 | Actuals FY2021 | Variance | RCA adjustments | RCA FY2021 |
|---|---|---|---|---|---|
| Regulated Assets Base (RAB) | 913 213 | 893 510 | (19 703) | 0 | (19 703) |
| Return on Assets (ROA) | 1.5% | 1.5% | 0 | | 0 |
| Return (Adjusted for government assistance) | (9 302) | (9 597) | (296) | - | (296) |
| Expenditure | 53 692 | 65 514 | 11 823 | (5 731) | 6 092 |
| Primary Energy | 67 966 | 73 114 | 5 148 | (2 130) | 3 018 |
| Independent Power Producers (local) | 35 314 | 32 470 | (2 844) | - | (2 844) |
| International purchases | 3 233 | 4 987 | 1 754 | - | 1 754 |
| Depreciation | 63 637 | 57 011 | (6 626) | - | (6 626) |
| Research & Development | 144 | 76 | (68) | - | (68) |
| Levies & taxes | 7 353 | 7 191 | (162) | - | (162) |
| Revenue | 222 037 | 204 326 | 17 711 | 1 479 | 19 189 |
| COVID-19 adjustment (7103GWh @ 116,15 average c/kWh) | - | - | - | (8 250) | (8 250) |
| Load shedding adjustment (1034 GWh @ 116,15 average c/kWh) | - | - | - | (1 201) | (1 201) |
| Service Quality Incentives (SQI) | - | 31 | 31 | - | 31 |
| **FY2021 RCA Balance due to Eskom** | | | | | **10 637** |
| Nuclear decommissioning from RCA 2013/14 decision liquidated over 10 years - (8th year of 10 years) | | | | | 83 |
| **Total RCA balance** | | | | | **10 720** |

5.4. Eskom has experienced an approximate 1% reduction in sales volumes per year. OUTA believes that this will accelerate as the new regulations regarding the licencing regime come online. Eskom cannot claim such losses as these would not have been reasonably predicted and therefore not eligible for claiming under the RCA. For example, Eskom has acknowledged that City Power has reduced their Eskom off-take using Kelvin power station more, and the City of Cape Town is trending lower as increasing numbers of customers are migrating to green energy sources.

5.5. Load shedding was calculated by Eskom at 570 hours of load shedding and Eskom has calculated this reduction as being 1034 GWh. This appears very low and OUTA would urge NERSA to scrutinse the calculations as presumably depending on the hours of load shedding, the volume of energy sent out would vary. Load shedding in the early hours of the morning would result in less energy being needed than load shedding at peak evening. The hours of load shedding need to be correlated with the time of day and the energy demand that was not met. It is also not clear if using an average tariff price accurately reflects the loss of revenue due to unsold electricity.

5.6. OUTA remains cynical as the lack of detail appears to underestimate the amount of energy that was taken out of the system due to load shedding. It is of course in Eskom's interests to underestimate the loss of revenue due to load shedding, given that the load shedding revenue is subtracted from any revenue variance that they can claim.

## 6. COVID-19 COSTS

6.1. According to Eskom, the first quarter of the year, during lockdown experience a year-on-year decline of 16.5% due to the national lockdown. However, even though mines supplying Eskom were allowed to produce, covid limitations reduced production.

6.2. Table 2 shows Eskom's sales variances per customer category. According to Eskom, there was a variance of 15 487GWh most of which can be attributed to economic slow down due to covid and would therefore be part of the revenue that Eskom should not be claiming.

See tabel 2 below:

*Table 2: Sales variances per customer category*

**Table 9: Sales variances per customer category, GWh**

| Category | Decision FY2021 | Actuals FY2021 | Variance |
|---|---|---|---|
| Agricultural | 5 697 | 5 461 | (236) |
| Re-distributors | 86 202 | 82 447 | (3 754) |
| Commercial | 10 631 | 9 696 | (935) |
| Industrial | 47 555 | 40 881 | (6 674) |
| Mining | 29 849 | 26 991 | (2 858) |
| Residential | 11 461 | 10 949 | (512) |
| Dx international sales[1] | 94 | - | (94) |
| Traction | 2 688 | 1 931 | (757) |
| **External sales** | **194 176** | **178 355** | **(15 821)** |
| Internal sales | 472 | 805 | 333 |
| **Total Local sales** | **194 648** | **179 161** | **(15 488)** |
| **Export sales** | **12 904** | **13 497** | **593** |
| *SAE* | *12 904* | *13 410* | *506* |
| *Dx international sales* | - | *87* | *87* |
| **Total sales to all customers** | **207 552** | **192 658** | **(14 894)** |

*[1] Dx international sales is reflected under export sales in actual mode to mimic AFS disclosure*

## 7. PRIMARY ENERGY COSTS

7.1. The need to negotiate a fair price for coal contracts is clearly something that can and should be foreseen and the failure to do so is a decision that is not prudent and has resulted in inefficiencies in coal contracts. But such costs should not be borne by the consumers.

7.2. OUTA is pleased to note that Eskom has outlined a number of contracts in this RCA document that it is pursuing to recover funds that were lost as a result of corruption.

7.3. For the period of this RCA, the country was locked down for weeks and due to the economic impacts of COVID, less electricity was sold. However, the RCA outlines how the diesel peakers and OCGT were used (at high cost) while dumping renewable energy (which then needed to be paid for). The rationale for this was apparently as the coal power stations could not be ramped down anymore to adjust to a lower demand. This illustrates the need for a transformed fleet to enable load followed for adaptable load. However, Eskom is still expecting the customer to pay for its system being unable to adapt to a flexible load. In addition, the load-shedding means more diesel used. For the OCGT fuel, this resulted in a an actual spend of R4 075'm which was R 3125'm over the allowed revenue.

## 8. STAFF COSTS

8.1. Importantly, Eskom's unbundled RCA allows scrutiny of the staff costs per division. *"Step 1 of the unbundling involved the creation of the distinct divisions being Transmission, Distribution and Generation. This resulted in the re-allocation of centralised staff that performed functions exclusively for a division being re-linked to that division".*

8.2. Eskom Generation reduced its staff complement by 325 people but have now filled "several operational vacancies" Eskom has also attempted to explain its staff costs per MW, claiming that it has med the World Bank benchmark. It appears that there was an error in the World bank norms and that using Generation fleet headcount for FY2021, the MW per employee is 3.6MW per employee – about 14000 employees. There is a lack of clarity in terms of whether the original World Bank calculated figure of 9.53MW per employee was calculated on the entire Eskom including the corporate section. The unbundling of Eskom allows for more transparency and it is useful to see that at least generation appears to be appropriately staffed.

8.3. However, there has been an increase of overtime due to maintenance issues. OUTA queries if all maintenance and overtime costs should be allowed to be recovered. Eskom's own admission is that this cost has doubled. Eskom application was for R558'm but the actuals are R 1104'm.

## 9. ESKOM FLEET MAINTAINANCE

9.1. Generation maintenance costs are still high. NERSA allowed R 9 754'm of the R10 511'm applied for in generation costs, but the actuals were R13 403'm. The variance of R3 650'm was offset by a saving in distribution maintenance which underspend by R2202'm.

9.2. According to Eskom, Medupi incurred additional maintenance of R681'm and most of the fleet appears to be exceeding its planned maintenance budget.

9.3. In Kusile, a repair was needed in an area which had just been repaired. *"Kusile 2 was expected to return to service after 10 days of boiler tube leak repairs, but the station reported that a leak was again detected in the same area where the repair was just done. This implied that the unit would not be able to return to service as previously committed."*

9.4. The key concern here is that while we understand that the ageing fleet needs additional maintenance, there appears to be technical incompetence if repairs must be repeated. Whether contractors or Eskom staff overtime, OUTA believes that additional scrutiny is needed and some of these costs should be disallowed. Consumers should not have to pay such apparent wasteful expenditure.

9.5. Delays in transmission and distribution maintenance were due to covid19 which meant lower than anticipated costs.

## 10. FINANCING THE GAP

10.1. Eskom has deferred several costs such as maintenance due to COVID. These are under expenditures in this RCA. However, for FY 2023, one assumes that Eskom will now incur that expenditure. It is important from an economic perspective that South Africans don't bear the costs of COVID19, so then who will bear the delayed costs which while not incurred in FY2022 RCA, might suddenly appear next year. Eskom may then find itself in a situation leading to doubling of costs which will be recovered from Eskom customers and applied for in the FY2023.

10.2. There are a number of court cases pending all of which if Eskom is successful, will lead to additional tariff increases. It can be assumed reasonably that businesses and households will find the next couple of years difficult as they attempt a post covid recover. This recovery will be severely impacted if Eskom electricity tariffs are allowed to rise beyond inflation. Eskom itself is expecting stagnant sales volumes of approx. 190TWh per year for the next 5 years.

10.3. It might be outside NERSA's mandate but there needs to be some intervention that enables Eskom to do the necessary maintenance and operations in a prudent manner but that does not impede economic recovery through increased tariffs.

## 11. CONCLUSION

11.1. On a broader strategic level looking at energy planning and energy security for South Africa going forward, the idea of a mechanism to allow Eskom to return to the regulator every year to gain approval for unforeseen cost increases leads to inconsistency and adds to the economic uncertainty in the country.

11.2. We have attempted to demonstrate that in the main, Eskom should know about the additional costs it incurred. Covid has meant that 2020/2021 were unusual years and Eskom has committed to not trying to recover its losses from its customers. However, in other instances, it is still our contention that Eskom fails to do its homework but continues to forecast its performance and revenue year on year with unproven assumptions. The RCA mechanism means that Eskom is not being made accountable for its bad planning and leads to increased burden for the consumer. We have also pointed out that many organisations, including ourselves have submitted the same critiques of Eskom's applications for several years.

11.3. OUTA would suggest that the MYPD provides the basis for a "contract" between society and Eskom, a price trajectory which South Africans can use to grow the economy. The rules that allow Eskom to continually apply and receive additional tariff increases based on reasons that in general fail to stand up to scrutiny. This is an unsustainable approach to electricity provision and has attracted further risk to the economy and society in general.

11.4. In conclusion, OUTA would argue that Eskom has acknowledged that it will not pass through the costs associated with COVID19 nor those associated with load shedding. OUTA is not certain that the methodology that Eskom puts forward to calculate those costs covers the extent of the expenditure. NERSA should therefore be cautious in granting any RCA related increases.

11.5. OUTA therefore recommends that Eskom is not awarded any further increases in electricity tariffs and that the entire RCA mechanism should be reviewed and potentially scrapped. This would ensure increased certainty and consistency in the price path of future electricity tariffs.

11.6. The new electricity pricing policy (EPP) which is currently out for public comment and the new tariff frameworks that are on the table will, we hope, resolve much of this uncertainty and remove the tariff uncertainty associated with the RCA.