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29 October 2024

The National Energy Regulator of South Africa
Kulawula House
526 Madiba Street
Arcadia, 0083
Pretoria

Attn: Mr Nhlanhla Gumede, full-time NERSA board member responsible for electricity regulation

Sent by email to: mypd@nersa.org.za

Dear Mr Gumede

Submission of comments by the Organisation Undoing Tax Abuse (OUTA) in respect of Eskom's MYPD6 revenue application

This submission is in response the publication of Eskom's revenue application and the associated NERSA consultation paper for its sixth multi-year price determination (hereafter referred to as MYPD6) for the three-year period commencing 1 April 2025, and NERSA's call for written comments to these by 16h00 on
1 November 2024.

The comments and responses below are submitted in terms of the above by the Organisation Undoing Tax Abuse (OUTA).

OUTA acknowledges and thanks Eskom and NERSA for the work and effort that has gone into the preparation of the MYPD6 revenue application and the associated consultation paper, and for the opportunity to comment and respond to these.

1. About OUTA

OUTA is a non-profit civil action organisation dedicated to working for a better South Africa. OUTA was established to challenge the abuse of authority, and particularly the abuse of taxpayers' money.

OUTA has a strong interest in the electricity sector, because the sector, including state-owned entity Eskom, has been mismanaged for years, resulting in power supply shortages, higher prices, socio-economic hardship for electricity customers, substantial bailouts with taxpayers' funds (which should have been available for alternative socio-economic spending), and a devastating impact on the economy.

2. **About this submission**

Eskom's MYPD6 revenue application has far-reaching implications and impacts on South Africa's electricity supply industry (ESI), electricity distribution industry (EDI), Eskom, electricity customers (residential, commercial, industrial, mining, agricultural, municipal and transportation), the South African economy, and society in general.

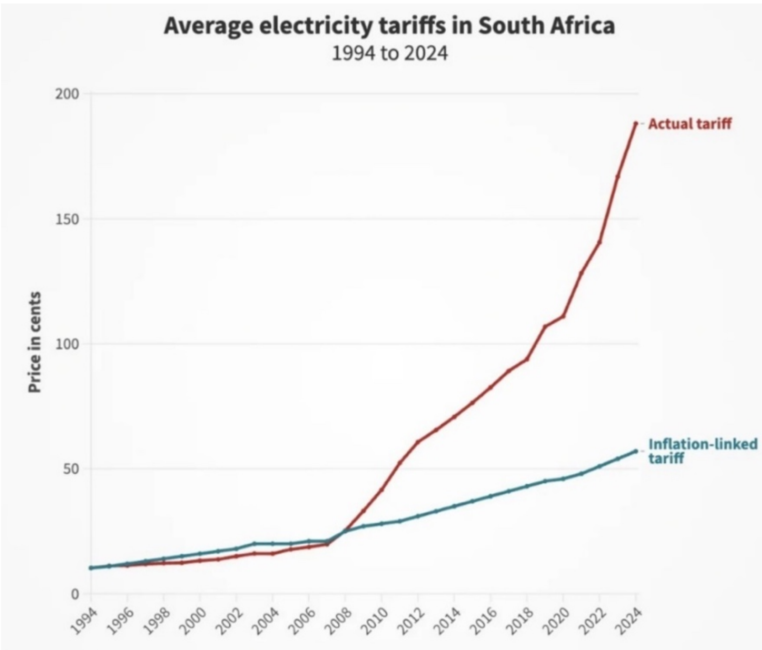
This submission reflects analyses and inputs by OUTA's executives and relevant staff that underpin this critical appraisal of Eskom's MYPD6 revenue application and the associated NERSA consultation paper.

The analyses, comments and subsequent recommendations contained herein, are based on significant inhouse research and evidence, as well as research, policy positions and reports by other civil society, community, business and industry associations, NGOs and other stakeholders.

3. **OUTA's broad response to Eskom's MYPD6 revenue application**

The President's emergency plan to end load shedding, the establishment of the National Energy Crisis Committee (NECOM) under the leadership of the Minister of Energy and Electricity, and the work done by Eskom Generation in terms of its generation recovery plan, has resulted in the achievement of 200+ days without loadshedding, and has shown what can be achieved with committed leadership and focus.

It is OUTA's view that a similar dedicated national effort and focus is now required to address issues of energy poverty, energy access, energy affordability, and the price of electricity which is spirally out of control.



While recognising the requirement for NERSA to allow Eskom to recover its prudently and efficiently incurred operating costs, plus a fair return on assets, through electricity tariffs, OUTA rejects Eskom's application for a revenue and average electricity price increase of 66% over the next three years, i.e. 36.15% on 1 April 2025, 11.91% on 1 April 2026 and 9.1% on 1 April 2027, coming as this does after 15 years of price increases that were significantly above the inflation rate each year.

Yet, despite the massive revenue and price increases over the last 15 years, Eskom's primary focus in its MYPD6 revenue application, remains to ensure cost reflectivity by increasing its revenues and electricity tariffs still further, while paying little attention to the many other alternatives and options of reducing its cost structure and improving its performance and efficiency.

In particular, the Eskom MYPD6 revenue application broadly demonstrates:

a) Inadequate signs of self-discipline in reducing Eskom's cost structure to ensure cost reflectivity.
b) Inadequate signs of self-discipline in reducing debt and finance costs to ensure cost reflectivity.
c) Inadequate signs of self-discipline in reducing losses to ensure cost reflectivity.
d) Inadequate signs of self-discipline in improving its financial and operational performance and efficiency to ensure cost reflectivity.
e) Inadequate signs of self-discipline in disposing of non-core assets that would reduce debt and associated debt service costs.
f) Inadequate appreciation by Eskom of the negative impacts of its massively increasing electricity prices on society, the economy and customers of electricity.

For example:

- Primary energy costs of R92.8bn allowed in FY2025 increases by 38% to R128bn in FY2026 in Eskom's MYPD6 application.
- Operating costs of R61.4bn allowed in FY2025 increases by 52% to R93.3bn in FY2026 in Eskom's MYPD6 application.

4. Eskom's outdated economic impact study

The Eskom economic impact study referred to in its MYPD6 revenue application is four years out of date, having been published in early 2022, based on work done in 2021 in respect of its previous MYPD5 revenue application.

The study referred to was commissioned and paid for by Eskom in respect of its MYPD5 application, and its conclusions cannot be considered as independent, appropriate and/or relevant to the MYPD6 application.

The suggestion by Eskom that the outdated study for MYPD5 somehow indicates that the 66% electricity price increase in its MYPD6 application over the next three years is generally good for the South African economy, is disputed and rejected – not only by OUTA, but by small, medium and large electricity customers is general, as well a wide range of civil society, business and industry associations.

OUTA recommends that NERSA should commission a new, up-to-date, independent socio-economic impact study to give a clearer picture of the real impacts of Eskom's application for a 66% revenue and electricity price increase over the next three years.

5. Negative impacts of Eskom's MYPD6 revenue application

OUTA's position is that the Eskom MYPD6 application displays a cavalier disregard for and an inadequate appreciation of the negative impacts of the proposed 66% increase on society, the economy and customers of electricity, coming as it does after 15 years of significantly above inflation electricity price increases.

In particular, OUTA is of the view that the Eskom MYPD6 revenue application demonstrates a seriously inadequate appreciation and consideration of the:

- Impact on the economy and therein on GDP.
- Impact on inflation.
- Impact on employment.
- Impact of safety, security and social unrest.
- Impact on electricity theft.
- Impact on non-payment for electricity.
- Impact on municipal electricity distributors.
- Impact on indigent and poor households.
- Income on middle income households.
- Impact on SMMEs, commerce and business.
- Impact on the agricultural sector.
- Impact on manufacturing.
- Impact on energy intensive industry.
- Impact on electricity demand in South Africa.
- Impact on Eskom sales volumes.
- Impact on future price increases.
- Impact on the utility's sustainability.

While the inflation rate in FY2025 appears to be dropping to around 4%, the 36.1% electricity price increase (i.e. nine times higher than the expected FY2025 inflation rate) in Eskom's MYPD6 revenue application for FY2026 will negatively impact all sectors of the economy.

Where electricity price increases above the inflation rate are unavoidable, OUTA recommends that every effort should be made to smooth and phase in such increases gradually to avoid shocks to electricity customers and the economy.

It is expected that through the NERSA consultation process a wide range of affected civil society, business and industry associations – covering residential, commercial, industrial, mining, agricultural, municipal and transportation sectors across the South African economy – will attest in detail to the negative impacts of the 66% electricity price increase over the next three years applied for by Eskom.

6. Eskom costs that must addressed to ensure cost reflectivity and limit massive electricity price increases

It is OUTA's view and position that the Eskom MYPD6 revenue application does not adequately drill down, identify, set and commit to clear targets for specific cost reductions, and performance and efficiency improvements across the major cost categories, such as:

- Primary energy costs.
- Staffing costs.
- Operation and maintenance costs.
- Cost of losses.
- Finance costs.
- Return of assets.
- Depreciation.

Each of the above is dealt with further below, as follows:

6.1 Focus on coal costs and associated cost reduction efforts

Coal and coal transport costs form a major part of the cost of primary energy, and it is OUTA's view that Eskom's MYPD6 revenue application does not demonstrate adequate attention and commitment to:

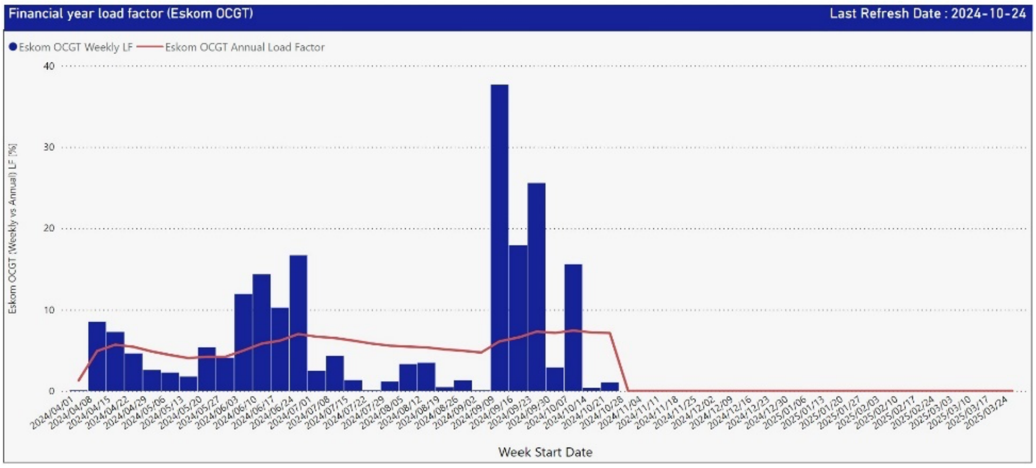
a) Reducing Eskom's overdependence on coal and rising coal costs.
b) Replacing old Eskom coal power stations with cleaner, lower-cost options.
c) Improving coal procurement management and associated skills.
d) Improving coal transport management and bringing coal transport costs under control.
e) Improving coal quality management.
f) Reducing corruption in coal procurement.
g) Reducing coal theft.

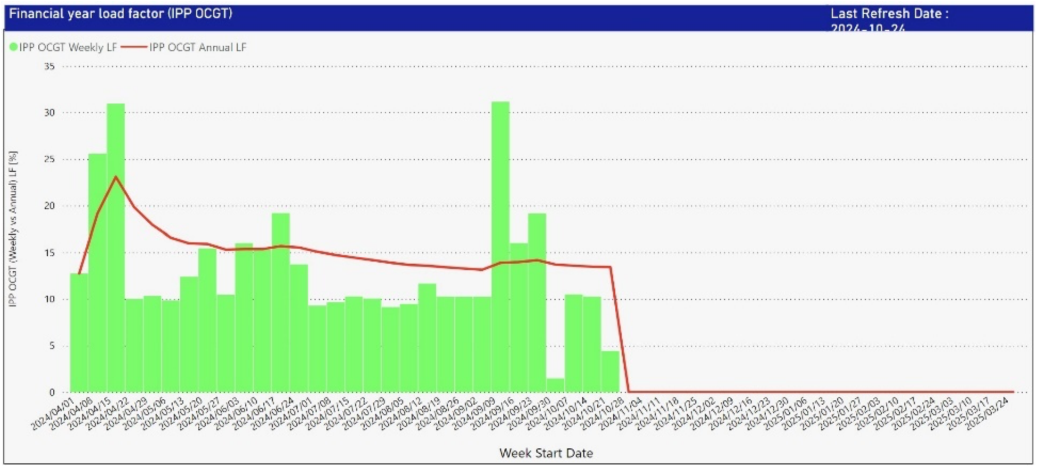
6.2 Focus on diesel costs and associated cost reduction efforts

Diesel costs also form a major part of the cost of primary energy.

While significant strides have been made in reducing diesel costs in FY2025 to date by improving the very poor operational performance of Eskom's fleet of coal-fired power stations, the operating load factors of the Eskom and IPP OCGTs, and the associated diesel burn, remain significantly higher than expected for efficiently and prudently operated emergency and peaking plant.

The figures in the graphs below indicate the Eskom and IPP OCGT load factor for FY2025:





It is OUTA's view that Eskom's MYPD6 revenue application does not demonstrate adequate attention and commitment to:

a) Improving diesel procurement management and associated skills.
b) Exploring Eskom as a licenced diesel trader to reduce diesel import costs.
c) Enabling diesel fuel tax recovery from SARS.
d) Reducing the load factors of the OCGTs to levels expected of emergency and peaking plant.
e) Use of OCGTs for their intended design purposes.
f) Use of BES and other short-term energy storage options to reduce OCGT load factors.
g) Conversion of diesel OCGTs to gas.

6.3 Focus on staffing costs and associated cost reduction efforts

A 2016 World Bank study estimated that Eskom was overstaffed by approximately 66%, with a suggested optimal workforce of around 14,244 employees, based on international utility benchmarks.

The study's methodology and conclusions have faced criticism and are strongly disputed by Eskom for using simplified benchmarks that do not account for Eskom's specific operational needs and network complexity.

It light of the above, OUTA recommends that NERSA should commission an independent study to:

a) Review Eskom's staff remuneration levels across the board.
b) Review Eskom's staff complement and staff levels across the board.
c) Review of Eskom staff hiring policies.
d) Downsizing and rightsizing Eskom's staff complement if necessary.

6.4 Focus on operation and maintenance costs and associated cost reduction efforts.

In the past there have been serious questions raised by NERSA and others as to the quality and effectiveness of Eskom's generation plant operation and maintenance (O & M) activities.

It is OUTA's view that Eskom should make every effort to improve the performance, quality and value for money in respect of Eskom's O & M activities, associated costs, and consideration be given to:

a) Outsourcing of power station O & M to more efficient and leaner external operators, while maintaining effective oversight quality of such operators.
b) Partnering with and outsourcing of critical maintenance and spares to competent OEMs.
c) Outsourcing of the provision of ancillary services to external service providers and operators.
d) Closing uneconomic, old power plants and replacing them with cleaner, more efficient and lower cost alternatives in a timely manner.

It is OUTA's view and position that Eskom's MYPD6 revenue application does not adequately demonstrate such efforts.

6.5 Focus on losses and loss management.

The impacts on Eskom and the economy of losses associated with electricity and infrastructure theft, non-payment of electricity, vandalism, procurement irregularities and corruption have been identified and widely reported for many years.

It is OUTA's view that Eskom's MYPD6 revenue application does not demonstrate adequate attention, commitment and set targets for:

a) Improving plant efficiency and reduction of technical losses.
b) Increasing asset protection and security arrangements.
c) Reducing coal, diesel and oil theft.
d) Reducing electricity theft and bypassing of electricity meters.
e) Reducing electricity revenue losses due to incorrectly connected /programmed meters.
f) Reducing electricity revenue losses due to ghost vending of prepaid electricity.
g) Reducing copper, aluminium and steel theft.
h) Reducing cable, line and transformer theft.
i) Reducing of asset vandalism.
j) Reducing municipal non-payment and improving collections from municipal distributors.
k) Reducing non-payment by Eskom's direct customer e.g. customers in Soweto.
l) Reducing losses due to corruption and procurement irregularities.

OUTA does not have accurate or complete data on the cost impacts of losses associated with electricity and infrastructure theft, non-payment of electricity, vandalism, procurement irregularities and corruption.

OUTA recommends that NERSA should commission an independent study of the cost impacts and to set the appropriate targets to reduce these losses, and that this should be taken into account by NERSA in determining Eskom's allowable revenue.

6.6 Reduction of finance costs

The reduction of Eskom's finance costs requires significant reduction of Eskom debt (currently estimated at about R450-billion) by strict adherence to National Treasury conditions for government bailouts to Eskom, including:

- Government bailouts only to be used to service debt repayments.
- Moratorium on new loan commitments.
- No capital expenditure by Eskom on new generation capacity.
- Concessioning of power station O & M for selected coal-fired power stations to competent external operators.
- Off balance sheet financing, concessioning, construction, operation and maintenance of new/upgraded transmission corridors to external operators.

Eskom debt can also be reduced by sale of non-core assets to increase its debt service cover ratio, including sale of:

- Telecommunications infrastructure.
- Real estate, land and property holdings.
- Non-essential business units such as Eskom Enterprises, Rotek and Roshcon.
- Non-strategic Eskom power stations including its OCGT, hydro and pumped storage peaking power stations.
- Eskom Finance Company

Eskom can also be recapitalised to reduce debt through:

- Collection of arrear debt from other public bodies – national, provincial and local government.
- Raising new share capital from the state and/or new external shareholders.
- Debt to equity swaps.
- Raising share capital and reducing debt through restructuring and listing certain Eskom entities on the JSE and other bourses.

It is OUTA's view that debt to equity swops, listing of Eskom entities on the JSE, taking on of external shareholders such as development finance institutions, banks, investment funds, pension funds, insurance companies and other public bodies does not reduce public control of Eskom's assets.

Instead OUTA's view is that this increases public participation in the business of Eskom and increases transparency and accountability of Eskom to the public and customers of electricity.

It is OUTA's view that Eskom is not demonstrating adequate attention, commitment and self-discipline in reducing its debt and the associated finance costs.

6.7 Return on assets

A significant contributor to the electricity price increase applied for in Eskom's MYPD6 revenue application is the step change in the return of assets on Eskom's depreciated asset replacement cost, from 1.5% (i.e. R15.6bn) allowed in FY2025 to 4% (i.e. R42.7bn) for FY2026, in Eskom's MYPD6 application.

It is OUTA's view that such step changes in the return on assets should be smoothed and phased in gradually to avoid price shocks to electricity customers and the economy.

Furthermore, the current depreciated asset replacement cost methodology to determine the regulatory asset base for Eskom's revenue application is considered inappropriate and lacking in transparency.

In OUTA's view, some of the inadequacies include:

a) Major generation assets such as Medupi and Kusile are significantly overvalued because of cost and time overruns during construction, fruitless and wasteful expenditure, maladministration, corruption and failure to meet performance specifications.
b) The final capital cost (including capitalised interest during construction) of Medupi and Kusile is still unknown, but is expected to be in excess of R500bn, more than R250bn over budget, and ten years late.
c) The levelised cost of dispatchable electricity from a combination of wind, solar and flexible generation technologies (BES, pumped storage and gas-to-power) continues to decline, making the replacement of old coal and old nuclear assets with new coal and new nuclear assets most unlikely.
d) The construction of new coal assets for the replacement of old coal assets is practically impossible due to environmental and climate change concerns.
e) The value of old coal and old nuclear assets is questionable due to unrealistic decommissioning, waste storage, waste disposal and other environmental liabilities.

OUTA's position is that the current methodology used by Eskom in its MYPD6 revenue application to value its regulatory asset base and to determine the return on assets required is inappropriate and outdated and should be independently reviewed.

6.8 Depreciation

A significant contributor to the electricity price increase applied for in Eskom's MYPD6 revenue application is the annual depreciation cost, based on the actual cost of Eskom's assets depreciated over the asset life.

As detailed above, it is OUTA's view that major generation assets such as Medupi and Kusile are significantly overvalued because of cost and time overruns during construction, fruitless and wasteful expenditure, maladministration, corruption and failure to meet performance specifications.

This results in unrealistically high depreciation costs reflected in Eskom's MYP6 revenue application.

OUTA's position is that the current methodology used by Eskom in its MYPD6 revenue application for depreciation costs determined by excessive actual capital costs (including excessive capitalised interest during construction) is inappropriate and lacking in transparency and should be independently reviewed.

Instead, it is OUTA's view that the depreciation costs for Eskom's MYPD6 revenue application should be based on the initial, board approved, budget capital cost (before any cost and time overruns), depreciated over the asset life.

7. Recommendations

While recognising the requirement for NERSA to allow Eskom to recover its prudently and efficiently incurred operating costs, plus a fair return on assets, through electricity tariffs, OUTA recommends that:

a) NERSA should broadly reject Eskom's application for revenue and price increases of 66% over the next three years, i.e. 36.15% on 1 April 2025, 11.91% on 1 April 2026 and 9.1% on 1 April 2027.
b) NERSA should shift the focus away from Eskom's application for massive, above inflation, revenue and price increases year after year, and instead focus on and signal the urgent need for improvement of Eskom's performance, efficiency and associated cost reductions to achieve cost reflectivity.
c) NERSA should adjust the balance away Eskom's focus on its own needs, towards an increased focus on the broader needs of society, the economy and the customer.
d) NERSA should adjust the balance to ensure a greater focus on accelerating the unbundling of Eskom, and associated ESI and EDI restructuring and market reform.
e) NERSA should adjust the balance away from the self-serving needs of the *de facto* Eskom and municipal monopolies, to focus on opening the industry to new players on level playing fields and allowing customer choice.
f) NERSA should focus on significantly increasing diversity in the power generation sector and increasing wholesale and retail competition in the supply of electrical energy.
g) NERSA should focus on significantly opening and increasing third-party access to critical, monopoly, public assets, such as transmission and distribution networks, for the benefit of electricity customers, the public, the economy and society.
h) This should include non-discriminatory, third-party access to transmission and distribution networks for traditional wheeling, virtual wheeling, token wheeling and trading of electrical energy.
i) Where unavoidable, NERSA should ensure that Eskom and municipal revenues, prices, tariffs and returns should be smoothed and gradually phased in to avoid electricity price shocks to customers and the economy.
j) NERSA should require a detailed plan from Eskom to shift more quickly towards cleaner, lower cost, electricity generation options.

k) NERSA should commission an up-to-date, independent, socio-economic impact study to give a clearer picture of the real impacts of massive electricity price increases over the next three years.
l) NERSA should commission an independent review of Eskom's staffing and staff remuneration levels across the board.
m) NERSA should commission an independent study of the cost impacts and set appropriate targets to reduce losses, and that this should be considered in NERSA's electricity price determinations.
n) NERSA should commission an independent review of the current methodology used by Eskom to value its regulatory asset base for the determination of an appropriate return on assets.
o) NERSA should commission an independent review of the current methodology used by Eskom to determine its regulatory asset depreciation costs.

8. Conclusion

We trust OUTA's comments in this response to the call for public comments by NERSA will be considered in its final multi-year price determination for the three-year period commencing 1 April 2025, and OUTA commits to further engagements on this matter, if required.

OUTA again acknowledges and thanks Eskom and NERSA for the work and effort that has gone into the preparation of the MYPD6 revenue application and the associated consultation paper, and for the opportunity to comment and respond to these.

Yours sincerely

Wayne Duvenage
Chief Executive Officer
The Organisation Undoing Tax Abuse (OUTA)