



PRESENTATION AT NERSA PUBLIC HEARINGS FOR ESKOM ON RCAS – 2ND, 3RD & 4TH YEAR OF MYPD3

CIVIL SOCIETY REFLECTIONS – BY RONALD CHAUKE
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WHO IS OUTA?

OUTA is a proudly South African non-profit Civil Action Organization formed to hold those in public office accountable and is funded and supported by ordinary people who are passionate about improving the prosperity of our nation.

VALUES

- ✓ Accountability
- ✓ Transparency
- ✓ Promotion and Protection of public interest
- ✓ Constructive engagement
- ✓ Strategic Partnerships
- ✓ Zero tolerance to corruption and maladministration
- ✓ Active citizenry

CONTEXT

- ❑ Eskom lodged its RCA applications in accordance with section 14.2.1 of the MYPD Methodology. Eskom is claiming that it suffered revenue under-recovery and higher primary energy costs to meet demand, whilst operating in an electricity system during the periods under review.
- ❑ The alleged revenue under-recovery during the 2014/15, 2015/16 and 2016/17 control period within the third multi-year price determination (MYPD3), amounted to R66.6bn which translates into R19.19bn, R23.63bn and R23.87bn respectively.

OUTA'S CONCERNS

- ❑ Weak adherence to corporate governance prescripts
- ❑ Rampant Corruption at Eskom
- ❑ Outcomes of Parliamentary Inquiry on SOEs & State Capture Commission of Inquiry led by Dep. Justice Raymond Ngcobo
- ❑ Deficient Regulatory Oversight – e.g. Build Programme – excessive cost overruns
- ❑ Primary Energy costs & Opex
- ❑ Reporting requirements
- ❑ Business model – ‘*not fit for purpose*’ & ‘*not sustainable*’
- ❑ No strategic direction of ESI reform

OUTA'S CONCERNS (CONT...)

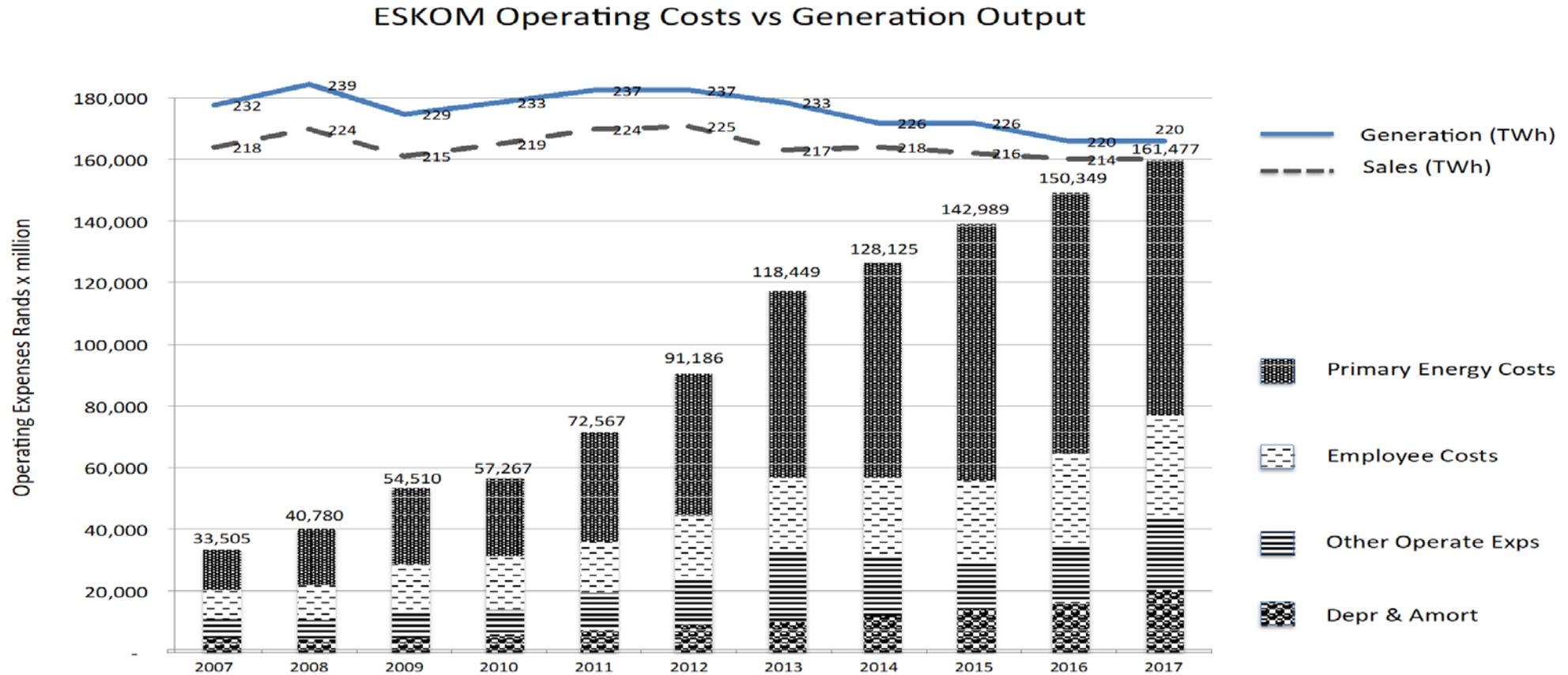
- ❑ OUTA is of the opinion that Rule 5.4.1 the MYPD methodology relating to qualifying criteria of expenses is grossly flawed, as it doesn't curb or minimise expenses, which could be ill-conceived or related to maladministration and/or corruption. It thus allows for prior year inefficiencies and undue expenses to be perpetuated into the future.
- ❑ Effectiveness of NERSA's Prudency Tests
 - ❑ Accounting for coal purchased for power plants – under prolonged breakdown period?
 - ❑ Accuracy of Regulatory Asset Base

OUTA'S CONCERNS (CONT...)

❑ MYPD Methodology shortcomings

- The change in RAB is determined in terms of rule 6.7.2.3 of the MYPD Methodology as shown below.
 - ✓ *“Eskom will annually report to the Energy Regulator on its capital expenditure programme, providing information on timing and cost variances”.*
- ❖ OUTA: “that’s why the build programme has exorbitant run-away cost overruns...it is not closely or regularly checked by NERSA – we strongly recommend that NERSA should at least rigorously monitor the expenditure quarterly & a report be compiled to ensure prudence and efficient capex spending.

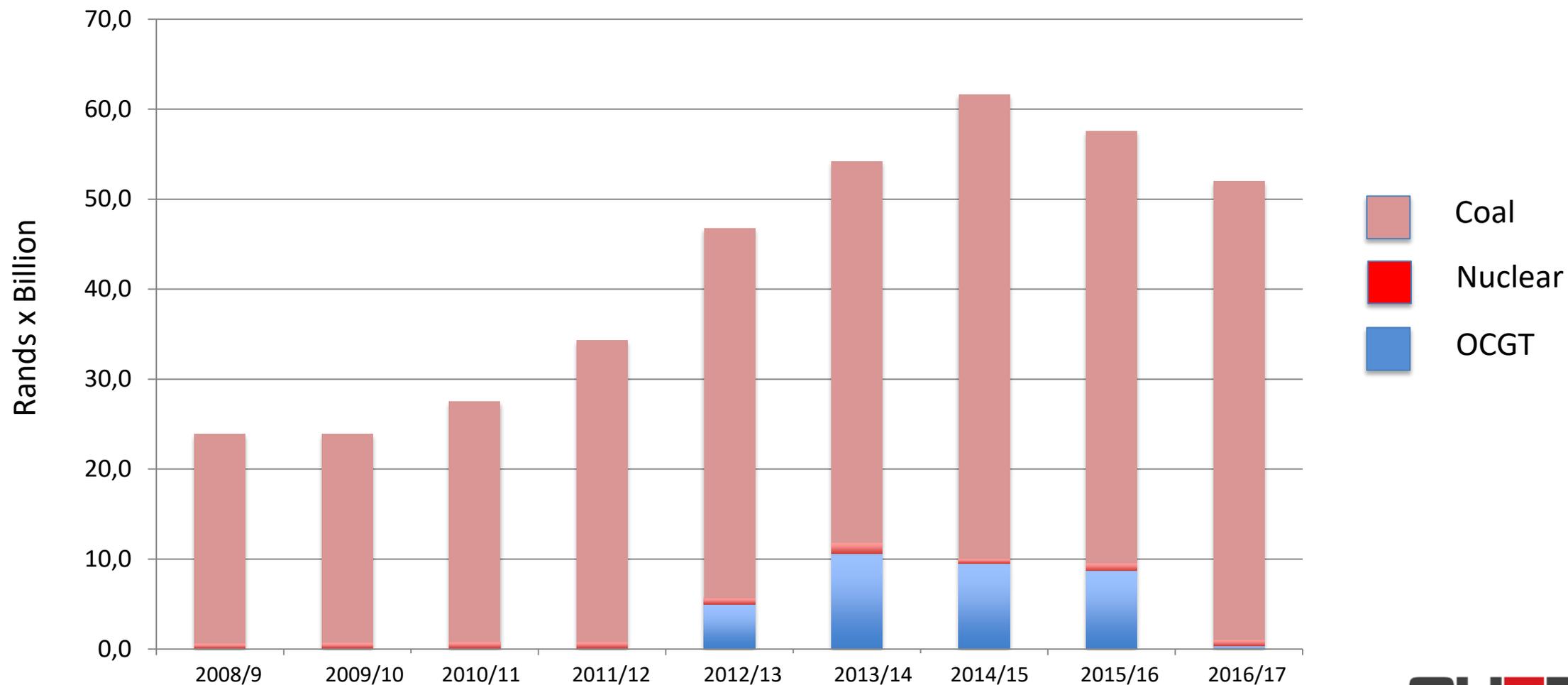
OPERATING COSTS VS GX COSTS



REPORTING BEST PRACTICE

- ❑ MYPD Methodology - Coal will be treated as a single cost centre without differentiating between the various coal sources (for example cost plus contracts, fixed price contracts, short-term contracts and long-term contracts).
- ❑ According to OUTA, the above practice creates a problem of aggregation while different prices are paid by Eskom to different mining houses, the impact of this is:
 - ✓ a breeding ground for corruption
 - ✓ prices that could be detrimental to economic development
 - ✓ create barriers of entry into the industry (anti-competitive behaviour could result).

ESKOM PRIMARY ENERGY COST: COAL, OCGT, NUCLEAR



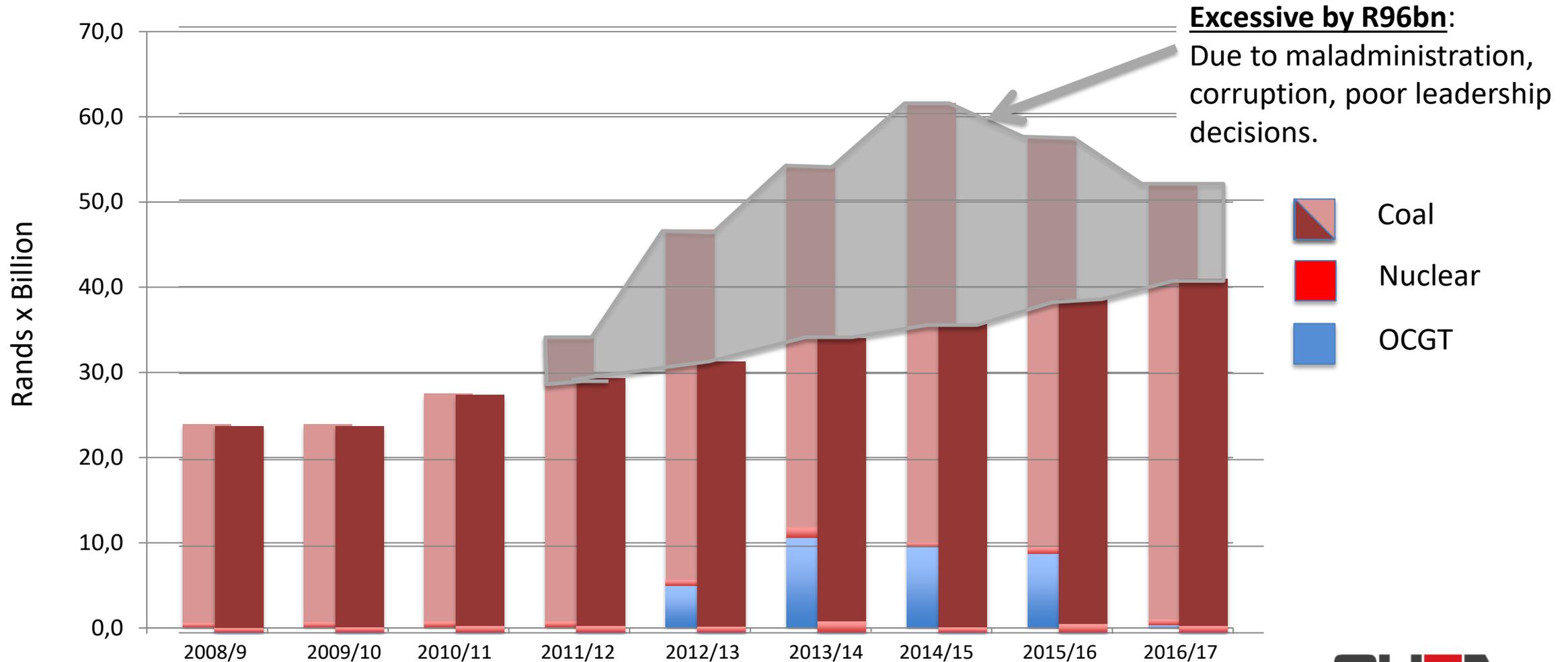
PRIMARY ENERGY

- ❑ No Transparency on coal contracts
- ❑ Poor plant performance, especially due to systemic & chronic breakdowns
- ❑ Inefficient procurement of coal – pricing & investment in security of coal supply
- ❑ Coal fleet decommissioning plans/schedule and cost implications in the medium to long term?
- ❑ Excessive use of OCGTs (the fundamental objective is in case of emergency, but now, why application is as if it's baseload at such high cost?)

OUTA'S ANALYSIS & OBSERVATIONS ON PRIMARY ENERGY

- ❑ The expiry and introduction of new coal contracts, more so the long-term contracts have not been disclosed, making it difficult for stakeholders to provide objective inputs and analytical comments on these RCA applications
- ❑ No indication of any future prospects for the procurement of cheaper coal sourced from competitive bidding process.
- ❑ Normalisation of price trajectory – OUTA applied
 - ✓ CPI + 2% in its calculations
- ❑ Inefficient procurement – leadership **NOT** always striving to derive value for money *(see graph in next slide)* as this translates to increased costs of corruption and maladministration amounting to **R96bn**.
- ❑ Take note that OUTA deliberately excluded the IPPs purchase costs and Environmental levy in the calculation of primary energy costs...for prudence reasons
- ❑ Utilisation of OCGTs should **ONLY** be during an emergency, but that's not the case

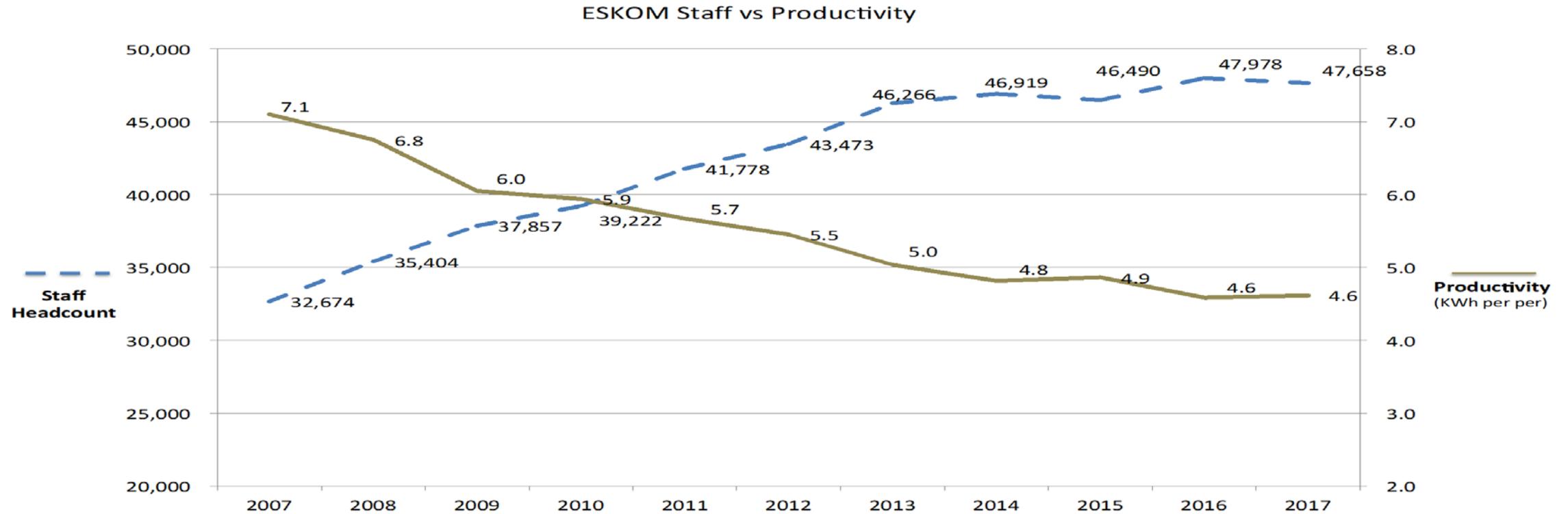
OUTA'S PRUDENT ESKOM PRIMARY ENERGY COST: COAL, OCGT & NUCLEAR



ESKOM PERSONNEL

- ❑ Eskom's personnel **productivity** has declined by 35%, from 7,1 to 4,6 GWh per person per annum from 2007 to 2017, as a result of increased staff / headcount from 32,674 to 47,658 over the same period, whilst output remained relatively flat over the same period (see table below).

ESKOM STAFF VS PRODUCTIVITY



REALITY CHECK

- ❑ In making its decision, NERSA must take into account the fact and reality that Eskom has been experiencing major structural challenges that are embedded in the vertically integrated utility's current business model and this can't be addressed by merely raising tariffs, but requires a holistic approach spear-headed by Government as part of instituting the requisite reforms of the electricity supply industry (ESI).

RECOMMENDATIONS

- ❑ 0% RCA claw-back approval
 - ✓ NERSA should only consider to credit the RCA in favour of Eskom once the turnaround strategy has been implemented
 - ✓ Subject to evidence of adherence to corporate governance prescripts
- ❑ Reporting requirements – specifics:
 - ✓ Clean and independent reporting of each primary energy category
- ❑ Primary Energy Procurement Strategy for Eskom
- ❑ Enhancement of Regulatory Framework
 - ✓ Stringent application of Prudency Testing by NERSA
 - ✓ Review of MYPD Methodology
- ❑ Eskom leadership must institute stringent measures to recoup the billions of rands siphoned out of the utility through corruption and maladministration to get immediate reprieve on its cash flow/liquidity challenges
- ❑ Concerted efforts by all parties, especially the Shareholder to reposition Eskom
- ❑ Promote ESI reform agenda by presenting options and technical proposal to Government.

THANK YOU!!!

BACK-UP SLIDES

REPORTING BEST PRACTICE

- ❑ Lack of transparency - for example, i.t.o. coal contracts and the following is not specifically disclosed:
 - a) Value and quantity of fixed assets such as mining equipment & machinery, etc.
 - b) % Ownership of particular mines.
 - c) % Return on investment in those mines.
 - d) Special agreements signed.
 - e) Pricing arrangements and its impact on primary energy pricing.
- ❑ Double counting – in case there is insurance payout – how is that accounted for vs claim in the RCA?

PRIMARY ENERGY

- ❑ Eskom is not an efficient operator
- ❑ During 2016/17FY, Coal purchases – the average price Eskom pays for coal was determined by the volume of coal procured from each type of contract [cost plus, fixed price and short-term/medium-term (ST/MT) and the price of coal from each type of contract, comprising average ST/MT costs of R458/t, Cost plus costs of R388/t and fixed price costs of R262/t (translating into a nominal average of **R369/t**).
- ❑ Primary energy costs escalated from R18bn in 2007 to more than R82 billion in 2017, which is equivalent to a more than 500% increase. OUTA is of the opinion that this is the breeding ground for corruption as it also includes the R11.7bn coal supply contract awarded in 2015 to the Gupta-owned Tegeta Exploration and Resources currently under business rescue.

NEW BUILD PROGRAMME

- ❑ **New Coal Build Project Costs Overruns** at Medupi, Kusile and Ingula have become untenable. Despite Eskom's RCA reference to the cost overruns of R6,1bn at Medupi and R14,7bn at Kusile and R1,6bn at Ingula these projects were originally budgeted and presented to NERSA as being R69.1bn, R80,6bn and R8,9bn respectively. The fact that the capital expenditure of these projects has escalated to around R195bn, R225bn (for Medupi and Kusile which are still incomplete), plus R36bn for Ingula at completion.
- ❑ OUTA objects to these excessive and grossly exorbitant cost overruns on these projects, which have now become a heavy burden to the consumer and the taxpayer. We therefore recommend that NERSA should exercise rigorous regulatory oversight on this matter and take account of the compounded impact of these overruns (when compared to from the original budget), which is attributed to Eskom's own doing. This is a matter and cost that cannot continue to be passed on to the consumer and shouldn't be credited to Eskom's account.

WORLD BANK REPORT

- ❑ A World Bank study in 2016 found that South African utilities pay workers more than double the norm in 35 other countries on the continent, with staff costs coming in at an average \$61 000 per employee per year. Eskom is potentially overstaffed by 66%, the report said.
 - “We have noted the World Bank study,” Eskom said.
- ❑ Eskom to handle over-staffing via attrition...is this the right intervention?

FUTURE OUTLOOK

- ❑ ESI Reform
- ❑ Clarification of Roles of key stakeholders & Commitment
 - ✓ Government
 - ✓ Regulator
 - ✓ Civil Society
 - ✓ Funders and Lenders
 - ✓ Independent Power Producers
- ❑ Security of Supply

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