

The logo for the Organisation Undoing Tax Abuse (OUTA). The letters 'OUTA' are in a bold, sans-serif font. The 'O', 'U', and 'A' are black, while the 'T' is red. The background of the top half of the cover features a low-angle shot of a steel lattice tower against a bright blue sky, with a sunburst effect from a light source behind the tower. The tower has several strings of lights hanging from it.

OUTA

ORGANISATION UNDOING TAX ABUSE

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OUTA submission to NERSA on Eskom's RCA 2018/19 application

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1. Introduction

The Organisation Undoing Tax Abuse (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, in particular the abuse of taxpayers' money. We have a strong interest in the electricity pricing process, because state-owned entity Eskom has been mismanaged for years, resulting in higher prices and social hardship for consumers, substantial bailouts with taxpayers' funds which should have been available for alternative spending, and a devastating effect on the economy.

This is OUTA's submission on Eskom's application to NERSA for Regulatory Clearing Account (RCA) revenue for 2018/19¹ (RCA 2019).

Table 1 below summarises Eskom's application:

Table 1: Summary of 2019 RCA Application

RCA for FY 2019	Decision FY 2019	Actuals FY 2019	Variance	RCA adjustments	RCA FY 2019
Total Revenue Rm	190 348	179 892	10 456	(5 006)	5 450
Primary Energy , Rm	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)
Research & Development (R&D)	112	90	(22)	-	(22)
Demand Side Management (EEDSM)	-	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 Balance Application					27 240
Nuclear decommissioning from RCA FY 2013/14 decision phased in over 10 years					83
Total RCA balance					27 323

¹ Eskom. August 2019. *Regulatory Clearing Account (RCA) FY2019 Submission to NERSA.*

From a reading of the rules² that NERSA has created around the review of Eskom revenue and what costs can be passed through to Eskom's customers, it appears that the RCA was set up to deal with coal cost variances which Eskom could not reasonably accurately forecast (see Appendix A). We deduce this as NERSA states that other primary energy costs are considered stable and less risky, and cannot be passed through.

If RCA is mostly concerned with coal 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 states 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."³

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.

OUTA believes 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.

OUTA submitted a summary of points to NERSA which we then elaborate on:

- a. 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.
- b. Eskom routinely overstates its sales predictions. This is because Eskom does not pay attention to the real world, where higher electricity prices and the increasing use by customers of embedded generation lower the demand.
- c. 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.
- d. Medupi and Kusile are years behind schedule and over budget, leaving Eskom with lower generation capacity than it should have plus higher costs for these power stations.
- e. Eskom spent R3.4bn more on diesel for the expensive OCGT generators to mitigate against load shedding, due to excessive breakdowns which should have been avoided.
- f. Staff costs are still out of control.
- g. Eskom doesn't compare like-for-like when comparing the costs of electricity produced from coal and from renewable energy IPPs. The renewables do not attract an environmental levy (a cost of about R7.8bn for Eskom for the year, charged on coal generation but not include in those costs), and Eskom also runs staff costs (including staff used on power stations) as a separate cost. These artificially lower the cost of coal-fired generation.

² NERSA: No date. *Multi-Year Price Determination Methodology*. Available at http://www.nersa.org.za/Admin/Document/Editor/file/Electricity/Legislation/Methodologies%20and%20Guidelines/MYPD%20regulatory%20methodology%20-%20%2020%20Nov%20_2_.pdf

³ 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>

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

In this submission, OUTA expands on the above points.

2. The RCA process: Repeating the same pattern but expecting different results

Civil society returns very year to present to NERSA on Eskom's applications for yet another tariff increase. We have noticed the same arguments being raised year after year and yet we do not see an improvement. We provide a brief review of previous inputs made at public hearings.

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." Does this mean that Eskom accepts that price is a driver of reduced demand? And yet, Eskom's MYPD3 application assumes that, contrary to what price elasticity trends have shown, electricity demand will increase by 1.9% compound annual growth a year over the MYPD 3 period"⁴.

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. How was repeating the mistake in 2014 going to fix the problem? Clearly it didn't.

And now Eskom has returned again, with the same story, and wants the people of South Africa to bail it out again.

Again, if we look at past civil society input into 2013-14RCA:

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 second example is drawn from data supplied by Eskom in its application (pg 154). During 2013/14, Eskom spent R1.36bn on DSM whereas the MYPD3 decision for the 2013/14 financial year was R1.46bn. The programmes installed resulted in 409MW of savings during the year. To save energy costs R1.36bn for 409MW = R2.53m per MW.

⁴ EGI-SA submission to NERSA 20 November 2012

Illustratively, to build coal, Medupi cost R105bn for 3990MW = R26.30m per MW, an order of magnitude higher. But Medupi is not up and running properly yet, and we are reliant on even more expensive electricity generation.⁵

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 way⁶.

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?

OUTA commends NERSA for its latest MYPD4 methodology (2018) which attempts to further regulate the details of how and which cost variances should be passed through to the customer. However, 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.

3. RCA 2019 repeats the demand problem

According to Eskom's RCA application, "Electricity sales during the period under review reflect a challenging macro-economic environment. The extreme drought conditions and depressed commodity prices put a damper on electricity sales in the agricultural and mining sectors respectively."⁷

This may be the case but the question is whether Eskom could have foreseen the challenging macro-economics and the drought.

Agriculture

The RCA application claim on drought depressing agricultural sales is contradicted by Eskom's own statistics. On page 44 of the RCA application, the variances between projected and actual electricity sales are provided. There is a variance of 111 GWh higher than the prediction. On page 47, there is an explanation for the increased sales: "This sector ended the year with a 111 GWh more than assumed in decision. This is due to the Free State, North West, Limpopo and Mpumalanga Eskom regions contributing a combined 113 GWh. The higher sales are mainly due to increased water pumping following the extreme temperatures and low rainfall experienced during the year, especially in the Western Cape".

It is difficult to reconcile the statement on page 9 with the statement on page 47. Eskom is claiming that agriculture electricity sales declined and should be compensated for this loss of income, but its own data show that sales increased.

⁵ With grateful thanks to Richard Halsey of Project90x2030.

⁶ From EG-SA member SAFCEI in submission to NERSA re Eskom's RCA 2013-2014 application.

⁷ Eskom. August 2019. *Regulatory Clearing Account (RCA) FY2019 Submission to NERSA*. Page 9.

Agriculture is charged the highest price of any sector by Eskom: 149.79c/kWh in 2018/19, compared to the average price in SA of 91.64c/kWh. This is an extra cost of R166m to the sector, which must have been devastating during a drought.

Mining

The second point at issue in the statement on page 9 relates to a decrease in mining-related electricity sales.

According to Eskom, the mining sector contracted by 13.7% in 2018 as compared to an expansion of 21.6% in the prior period (RCA application page 43). In the variance table on page 44, it can be seen that mining declined by 1 622GWh.

What was the financial implication of this?

Eskom charged mining 91.64c/kWh in 2018/19, so this was a loss in revenue of R1.486bn. If the cost of producing electricity (71.25c/kWh in 2018/19, a total of R1.156bn) is deducted, Eskom lost a profit of about R331m.

Could this have been reasonably predicted?

In 2016, Prof Jan du Plessis wrote: “Escalating electricity costs have become one of the biggest expenditure drivers in mining operations. During the last eight years, energy costs have trebled when expressed as a percentage of total running cost in South African mines”.⁸

In 2014, the Department of Energy produced its first monitoring report on Energy Efficiency, in which it stated: “Measured in terms of energy consumed per unit of value-added, the energy intensity of the industry & mining sector decreased by 29.9% between 2000 and 2011”.⁹ The report did speak of variances but it was commenting on trends. In 2017, Goldfields proposed a 40MW solar plant for its deep-south mine.¹⁰ In a 2016 media article, Gold Fields CE Nick Holland said South Deep’s annual power bill had reached R500m, forcing the group to seek alternative energy sources. “If that doubles in five years, that’s another R500m for us a year,” Holland said. “What about the rest of the industry? How are they going to cope?”¹¹

Eskom, in its MYDP3 RCA application for 2013/14¹² (RCA 2013/14) stated that the contribution of the energy intensive mining sector was starting to “dwindle” (Eskom RCA page 43).

Also in Eskom’s RCA 2013/14 application it stated that “The MYPD 3 sales growth over the 5 year period (i.e. 2013/14 to 2017/18 volumes) was assumed to be 7.3% while the actual average growth

⁸ Prof Jan du Plessis. 18 January 2016. *Energy efficiency in the mining industry*. Published in BizCommunity. Available at <https://www.bizcommunity.com/Article/196/723/139231.html>

⁹ Department of Energy. 2014. *South Africa’s Energy Efficiency Targets: First annual monitoring report*. Available at: <http://www.energy.gov.za/EEE/reports/First-Annual-Monitoring-Report.pdf>

¹⁰ Tsakani Lotten Mthombeni. 22 November 2016. *The role of alternative energy in addressing mining’s energy challenges: our experience*. Available at: <https://rmi.org/wp-content/uploads/2017/10/RMI-GoldFields-Role-Alternative-Energy-Addressing-Mining-Challenges.pdf>

¹¹ Dineo Faku. 16 August 2019. *Gold Fields raises concerns over power costs at its South Deep mine*. Independent Online. Available at: <https://www.iol.co.za/business-report/companies/gold-fields-raises-concerns-over-power-costs-at-its-south-deep-mine-30842364>

¹² Eskom. November 2015. *MYPD 3 (Year 2013/14) Regulatory Clearing Account Submission to NERSA*. Available at <http://www.nersa.org.za/Admin/NewsAndPublication/UploadImages/MYPD3%20-2013-14-%20Regulatory%20Clearing%20Account%20-%20Submission%20to%20NERSA3736132015013630.pdf>

rate per annum amounts to 1.8%” (page 43). In the Eskom reopener (April 2015)¹³, Eskom once again acknowledged that “Even though the demand for electricity has not increased as assumed since the MYPD 3 decision, the challenges faced with the supply options have resulted in significant shortfalls” (our emphasis).

Industrial

Eskom in its RCA 2013/14 application notes a decline in industrial sales (5 156 GWh) due to commodity prices and moves to alternative energy sources, and a decline in mining (3 555 GWh) due to “labour unrest” and the commodity prices etc.

For this 2019 RCA, Eskom shows that the industrial sector showed an increase in sales of 567 GWh. This was attributed to “the offer”. In Feb 2017, a media article suggested that Eskom was going to offer special pricing agreements to industrial customers because it had a surplus of electricity¹⁴. However, the article stated “*In the past when Eskom had excess supply, it followed a similar policy with the sale of cheap electricity to South32, formerly BHP Billiton, and its large aluminium smelters, Hillside and Bayside in Richards Bay, and Mozal in Mozambique. But the contracts hurt the utility financially and, during load-shedding, public anger was directed at the smelters because of their drain on power*”.

The Department of Energy published the framework for short-term negotiated pricing agreements (NPAs), to sustain and grow the South African economy through increased electricity consumption. This framework dated 22 June 2018 contains the following clauses¹⁵:

The Framework for Short-term NPAs (hereafter STF) has been specifically structured to provide opportunities to sustain existing businesses that are at risk of failure and permit others that have closed production capacity in recent years, owing to their inability to compete in their markets, to restart these assets. This will increase the utilisation of SA’s electricity infrastructure, resulting in a lower unit cost of electricity than would otherwise be the case, to the ultimate benefit of all electricity consumers in SA. The major economic benefits to SA anticipated from implementation of the STF may be summarised as follows:

- Direct and indirect jobs saved by preventing a number of business failures;
- Direct and indirect jobs saved by avoiding the closure or mothballing of Eskom generation capacity;
- New direct and indirect job opportunities owing to the restarting of unused productive capacity;
- Increased economic activity;
- Lower unit cost of electricity;
- Higher tax and Electricity Levy collections;
- Stronger Rand from an improved Balance of Payments; and

¹³ Eskom. *MYPD 3. Re-opener for selective items (2015/16-2017/18): OCGTs and STPP including the impact of environmental levy changes*. Available at: [http://www.nersa.org.za/Admin/Document/Editor/file/Consultations/Electricity/Documents/MYPD%203%20Reopener%20with%20levy%2030042015Publishable%20\(6\).pdf](http://www.nersa.org.za/Admin/Document/Editor/file/Consultations/Electricity/Documents/MYPD%203%20Reopener%20with%20levy%2030042015Publishable%20(6).pdf)

¹⁴ Lynley Donnelly. 10 February 2017. *Can Eskom woo the big spender?* Mail & Guardian. Available at: <https://mg.co.za/article/2017-02-10-00-can-eskom-woo-the-big-spenders/>

¹⁵ Department of Energy. 22 June 2018. *Framework for short-term negotiated pricing agreement to sustain and grow the South African economy through increased electricity consumption*. Available at: <http://www.energy.gov.za/files/policies/Electricity-Pricing-Policy-Position14Negotiated-Pricing-Agreements.pdf>

- Reduced Social Grant burden on the fiscus.

As Eskom appears to have signed up industrial companies for cheap power, the increase in industrial sales in the RCA application is assumed to be due to the lower tariffs. It is not clear whether, if the RCA is successful, those customers who have signed these NPAs will then be exempt from RCA tariff increases.

It is therefore difficult to conclude that as electricity prices increase, Eskom should not have foreseen an overall decline in industry and mining electricity revenue.

From the special pricing arrangements, it would seem that Eskom foresaw a reduction of sales and tried to tie industrial customers into longer term pricing contracts. While this might be an attempt to stem sales reductions, if the revenue gained is not at the level of the tariff that Eskom claims it needs, then how does it help Eskom's financial viability?

It is also clear that instead of trying to rein in electricity price increases, the Department of Energy is providing a mechanism for Eskom to selectively exempt certain customers. This appears to be increasing inequity and OUTA views such retrograde steps with alarm.

Municipal and residential

Page 44 of the RCA application states this:

Municipalities ended the year 986 GWh below what was assumed: ¹⁶

- Western Cape region contributed 301 GWh less than assumed, as a result of intensive energy savings in the Cape Metro and various other municipalities in the Western Cape. The impact from the drought in the Western Cape also negatively affected the sales.
- Kwa-Zulu Natal (KZN) region was 574 GWh lower than assumed mainly due to Richards Bay Alloys switching off their two furnaces. In addition, Karbochem lowered production due to feedstock shortages and technical plant problems.
- The Southern region (Eastern Cape) was 122 GWh lower than what was assumed due to third party infeed or wheeling which offset the consumption taken from Eskom in Nelson Mandela Bay municipality.

According to Eskom, municipal sales declined in the Western Cape due to energy savings, in KZN due to industrial closures, and in the Southern Cape due to a wheeling arrangement. Could these reductions have been predicted by Eskom?

We will not discuss the KZN industrial demand as we think it is covered by referring back to the industry discussion in the section above.

We would highlight the Southern Cape wheeling agreement with the Nelson Mandela Bay municipality. In a February 2018 media article, the wheeling agreement is described, arising from a pilot in 2006, obtaining a licence in 2013-2014 and expanding from there.¹⁷

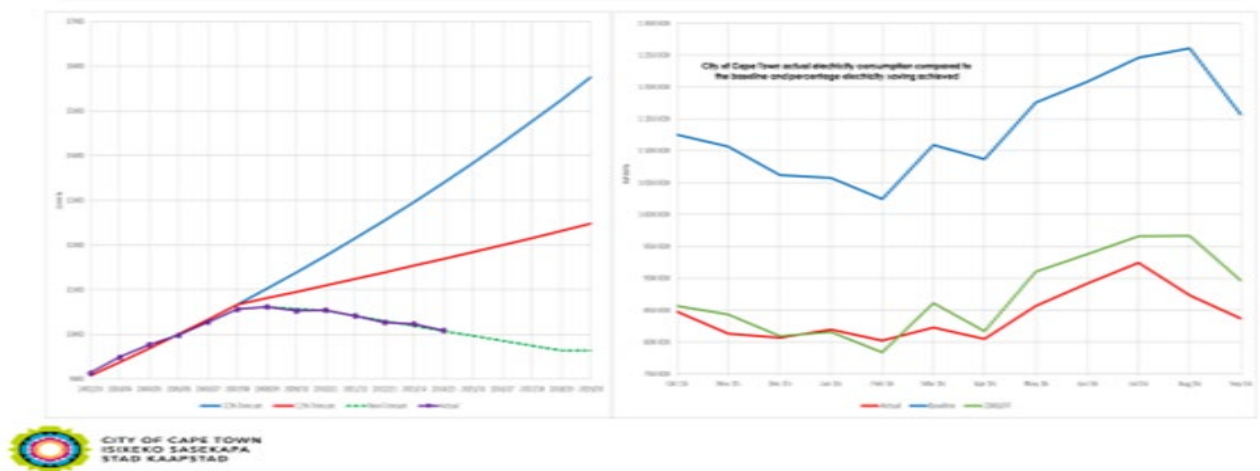
¹⁶ Pg 44 of the RCA application 2018/19

¹⁷ Antoinette Slabbert. 12 February 2018. *Electricity trading is alive and growing in South Africa*. Moneyweb. Republished in Cape Business News. Available at: <https://www.cbn.co.za/news/electricity-trading-is-alive-and-growing-in-south-africa/>

We would therefore ask how it is possible that Eskom could not have foreseen a reduction in sales from this existing operation in the Southern Cape.

For the Western Cape issue, we refer to the city of Cape Town submissions to various NERSA hearings in the past.

Electricity demand Cape Town 2006/7 – 2015/16



The above slide has been presented at various NERSA hearings and at other tariff related hearings. The trend is clear. Yet in the MYPD4 application, Eskom again claimed that municipal demand made up 41% of their sales and would increase each year¹⁸.

In the 2015 MYPD 3 re-opener, SALGA made the following comments:

SALGA asserts that implementing the selective reopener will result in further increasing non-payment and electricity theft. Both of these will negatively affect municipalities and will in turn lead to more distributing municipalities defaulting on their bulk electricity payments to Eskom. It is proposed that a less steep path of price increases should be considered. SALGA is committed to the financial viability and long term sustainability of Eskom. SALGA proposes that the end customer has a burden of a higher than inflationary tariff increase to bail out the utility. This is deemed unfair, unaffordable and unjustified.¹⁹

In the 2013/14 RCA application Eskom notes:

Historically, payments by municipalities are strongly correlated to them receiving the equitable share from National Treasury. Previously this funding was sufficient to settle outstanding electricity debt, but this is no longer the case with municipalities facing increased electricity prices and reduced funding.

The media over the last few years have raised the issue of non-payment of municipal electricity accounts. This is common knowledge as is the impact of the rising cost of electricity on the ability of the poorer and more vulnerable citizens to pay.

This is not a new phenomenon as indicated by the following in a 2011 HSRC report:

¹⁸ Distribution Licensee MYPD4 September 2018 (page 24). Eskom.

¹⁹ Page 24 of Eskom MYPD3 reopener application 2015

We looked at the impact of a once-off 25% increase in the electricity price. In this case, the Consumer Price Index (CPI) for all households rises by 0.88%, with 0.53% coming from direct effects and 0.35% from indirect effects. The impact is greater on poor households than on rich ones. This is driven almost entirely by the direct impact, which in turn is driven by the relative shares of total expenditure on electricity. Thus the richest households allocate 0.8% of their expenditure to electricity, so the 25% price rise raises their expenditure by 0.2%. By contrast, the poorest households spend 5.4% of expenditure on electricity, so the 25% increase raises their expenditure by 1.35%. Against this, the indirect effects are relatively uniform across household groups, contributing **0.40%** to the CPI increase for the poorest **and 0.32%** to that for the richest".²⁰

Rising residential tariffs over the last decade have certainly continued to impact more on the poor and vulnerable in the same way as highlighted above. Rising electricity tariffs are unsustainable, and we would argue a driving force for increasing inequity in the country.

StatsSA pointed out that by 2018, municipalities were increasingly using off-grid energy to service some indigent households, through the implementation of Free Basic Alternative Energy (FBAE). From this article: "To what extent are municipalities providing these sources, including solar energy? Of South Africa's 213 local and metropolitan municipalities, 49 indicated that they are servicing indigent households with at least one form of off-grid energy source⁵, according to the *Non-financial census of municipalities* report".²¹ Other sources which indicate the extent of energy poverty include the general household survey for example.

It is therefore not surprising that municipalities are struggling to get their communities to pay electricity bills.

Eskom's RCA application includes a breakdown of sales variances in GWh over the year.²²

Table 11: Sales variances per customer category, GWh

Category	Decision FY 2019	Actuals FY 2019	Variance
Municipalities *	88 249	87 264	-986
Industrial	48 149	48 717	567
Mining	30 594	28 972	-1 622
Traction	2 830	2 831	1
Residential	12 437	11 748	-689
Commercial	10 585	10 558	-27
Agricultural	5 685	5 796	111
Internal Sales (at Standard Eskom tariff)	538	459	-79
IPP sales	--	67	67
Total Distribution Sales	199 067	196 412	2 655
Note: * Includes standard tariff sales to Lesotho			
Note: Above-mentioned categories include NPA sales			

²⁰ Dr Miriam Altman et al. March 2011. Electricity Pricing and Supply with special attention to the impact on employment and income distribution: Final Report. HSRC. Available at: <http://www.hsrc.ac.za/uploads/pageContent/3022/Making%20informed%20decisions%20about%20electricity%20-%20SDC%20-%20Jan%2030%20-%2011%20v4.pdf>

²¹ Statistics SA. 4 June 2018. Energy and the poor: a municipal breakdown. Available at: <http://www.statssa.gov.za/?p=11181>

²² Table 11, page 44 of Eskom's RCA 2018/19 application.

In conclusion, we have shown that for the majority of the demand variations, Eskom should have been able to foresee them and we would therefore strongly recommend that associated costs should not be allowed.

How did Eskom calculate the revenue losses?

In table 11 above, Eskom lists the sales variances for each category in GWh. These are for South African sales only. There is no listing of revenue changes for each category.

In Table 1, Eskom’s summary of its application, the total allowable revenue for 2018/19 is listed as R190 348m against actual revenue of R179 892, a variance of R10 456. To cover this, Eskom wants an additional R5 450m through the RCA. Eskom says this includes all billed revenue and after “adjusting for non-electricity revenue, adjusting for demand response revenue as well as not including any load shedding volume in the variances”.²³

We used Eskom’s Integrated Report 2019 to calculate the average price of electricity which Eskom charged each sector.²⁴ The Integrated Report doesn’t include prices for IPPs or Internal Sales; for the Internal Sales we used the Standard Eskom Tariff of 93.79c/kWh referred to by Eskom in the RCA application²⁵.

Below, we take Eskom’s Table 11 on sales variances, and add extra columns with the average price of electricity per sector. Using those average prices and the GWh sold, we calculate the revenue losses per sector.

Table 11: Sales variances per customer category, GWh

Category	Decision FY 2019	Actuals FY 2019	Variance GWh	Average price in c/kWh	Value of losses in R'm
Municipalities *	88 249	87 264	-986	88,53	-R872,906
Industrial	48 149	48 717	567	73,99	R419,523
Mining	30 594	28 972	-1 622	91,64	-R1 486,401
Traction	2 830	2 831	1	110,17	R1,102
Residential	12 437	11 748	-689	125,73	-R866,280
Commercial	10 585	10 558	-27	117,30	-R31,671
Agricultural	5 685	5 796	111	149,79	R166,267
Internal Sales (at Standard Eskom tariff)	538	459	-79	93,79	-R74,094
IPP sales	--	67	67		
Total Distribution Sales	199 067	196 412	2 655		-R2 744,460
Note: * Includes standard tariff sales to Lesotho					
Note: Above-mentioned categories include NPA sales					

²³ Table 1, page 8 of Eskom’s RCA 2018/19 application, with note on revenue below the table.

²⁴ Eskom Integrated Report 2019. *Customer information*. Page 182 and 183.

²⁵ Eskom standard tariff rate of 93.79c/kWh, listed on page 33 of the RCA application.

We calculate the value of the variances as an overall revenue loss of R2 744.460m. If Eskom's average standard tariff of 93.79c/kWh is used, it's a revenue loss of R2 490.125m.

But Eskom is claiming R5 450m, which is about double. How is this calculated? Did Eskom offer massive discounts to one or more sectors, and expect to cover these losses in the RCA application by spreading them across other sectors?

Table 10 of Eskom's RCA application states that NPA sales were predicted to be 10 985 GWh and were actually a little lower at 10 482 GWh. If this accounts for these huge losses, then how much were the discounts on the NPAs?

Is Eskom perhaps hoping to cover its losses in international sales (which are not supposed to be part of the RCA application)? The customer information in the Integrated Report 2019²⁶ shows that Eskom has two categories of international customers: eight utilities and three "end users across the border". The sales (in GWh) and the revenue for each category indicate an average price per kWh of 111.89c/kWh for the utilities and 49.86c/kWh for the three "end users across the border". Eskom's Integrated Report shows the electricity operating cost²⁷ as 71.25c/kWh.²⁸ Eskom thus sold 8 768GWh of power to just three international end-users in 2018/19 at a loss of 24.39c/kWh, a loss of R2 139m. Table 12 in Eskom's RCA application²⁹ indicates that almost all of this appears to have been sold to Motraco. Motraco's website says this is the Mozambique Transmission Company, which was established in 1998 specifically to provide power to the Mozal aluminium plant in Mozambique.³⁰ While the subsidised tariffs to smelters have long been known – and criticised – this underlines the massive loss to Eskom. That loss over the last seven years (2012/13 to 2018/19) to those three end-users is about R13 340m.³¹

These international losses are not supposed to be covered by South African customers, but we wonder if they are being built into our prices. How else does Eskom cover this loss? It's worth noting that those three cross-border end users getting the enormous subsidies from Eskom are not in South Africa, so don't pay tax to the SA government.

4. Operating costs

From a reading of the rules that NERSA has created around the review of Eskom revenue and what costs can be passed through to Eskom's customers, it appears that the RCA was set up to deal with coal costs variances which Eskom could not reasonably accurately forecast. We deduce this as

²⁶ Eskom Integrated Report 2019. *Customer information*. Page 182 and 183.

²⁷ Eskom defines the electricity operating cost per MWh as "Electricity-related costs (primary energy costs, employee benefit costs plus net impairment loss and other operating expenses, less other income) divided by total electricity sales in GWh multiplied by 1000". (Eskom Integrated Report 2019, Glossary, page 158).

²⁸ Eskom Integrated Report 2019, *Non-Technical Statistics: Group and Non-Technical Statistics: Company*. Pages 174. The group cost is R712.47/MWh (71.25c/kWh) and the company cost is R728.85/MWh (72.89c/kWh). We used the group (lower) cost.

²⁹ Table 12: Export sales variances, on page 48 of Eskom's RCA 2018/19 application.

³⁰ <http://www.motraco.co.mz/index.php/en/>

³¹ Based on statistics in Eskom Integrated Reports.

NERSA states that other primary energy costs are considered stable and less risky, and cannot be passed through.

If RCA is mostly concerned with coal 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 states that only efficient costs will be allowed.

According to Eskom, “The decline in plant availability from 2013 meant that even less capacity was available to meet demand and thus required the available plant to run even harder resulting in a ‘vicious circle’”³². Eskom has described the lack of maintenance as the main contributor, as the “increase in maintenance was the major contributor to the improvement in plant availability in the 2017 and 2018 financial years. This improvement was, unfortunately, short-lived and availability started to decline again from late 2017. The reasons for this latest decline are many, complex and varied. The historical sub-optimal mid-life refurbishments and hard running of an ageing fleet (more than half – including Medupi and Kusile – over 37 years) still has the highest impact on plant failures.”³³

The lack of maintenance was foreseen, and so how is it possible that Eskom can claim that a loss of revenue due to plant unavailability is justified?

Should the utility claim that shareholder interference prevented proper maintenance and extended the risk of unplanned outages, it could be argued that the shareholder should provide compensation through foregoing its profits and providing some form of bailout. However, it is not clear why the impact of political interference should be passed through to customers in the form of increased tariffs.

IPPs

In the section on IPP costs, Eskom describes how additional payments had to be made to renewable IPPs due to Eskom’s failure to connect these power plants to the grid.³⁴ Additional payments were made due to dumping the IPPs off the grid due to low demand, and the need to keep the coal fired plants going at their lowest level to avoid having to shut them down and then risk having to cold start them again, with the need to then increase diesel at peak times. This reflects the chain of problem. Had Eskom prioritised connecting the IPPs, maybe it would have had sufficient power to not need all the coal power stations, and potentially would not then have needed to dump IPPs as well, thereby incurring additional costs. This is speculative but raises additional questions about Eskom’s political will to transition away from coal.

In considering how Eskom compares the costs of different generation options, we note the following:

In its submissions to NERSA, Eskom compares the primary energy costs of its own generation vs the REIPPs, making the current renewable energy project generated electricity appear to cost nearly eight times as much as Eskom generation. However, if you include the costs of employees, the generation capex and depreciation etc costs into the Eskom generation costs, which are already included in the REIPPP price that Eskom pays to IPPs, the picture changes with Eskom generation then only about half the cost of renewable energy. If you add in environmental costs of Eskom

³² Eskom RCA 2018/19 application, page 50.

³³ Eskom RCA 2018/19 application, page 51.

³⁴ Section 10.4.1.2 *Demand energy payment*, Eskom RCA 2018/19 application, page 59.

cleaning up its generation fleet, even if spread over five years, then Eskom is about 60% of the costs of round 1 expensive renewables.

The table below provides the calculations comparing Eskom generation numbers as supplied by Eskom in both the MYPD4 and RCA 2019 applications:

Costs (R'm)	Eskom Generation (their version)	Eskom generation (real)	IPPs
Primary energy	R54 896	R54 896	R21 300
Employees (generation and corporate)		R30 616	
Environmental levy		R8 061	
Tx and Dx capex		R9 286 (95%)	R489 (5%)
Tx and Dx opex ³⁵		R10 983 (95%)	R578 (5%)
CAPEX generation		R34 836	
Depreciation		R64 651	
Environmental costs R200bn spread over 5 years) ^{36 37 38}		R40 000	
TOTAL	R55 896 (93%)	R253 329 (93%)	R22 367 (7%)
	Eskom Generation (their version)	Eskom generation (real)	IPPs
GWh (2019 projected)	219 081	219 081 (95%)	11 451 (5%)
Cost (R'm) per unit (GWh) of elec (R/kwh)	R0.255/kWh	R1.156/kWh	R1.953/kWh

For 2024, Eskom predicts that the cost of Eskom primary energy generation will double. As the Integrated Resource Plan 2019 (IRP 2019) indicates, the predicted costs of renewable energy power plants will proportionally decrease as cheaper renewable power plants come online. Even if the actual costs of renewable energy stayed the same, when Eskom costs double, this means that within

³⁵ Eskom RCA pg 131 – table 58

³⁶ <https://www.iol.co.za/saturday-star/news/eskom-slams-misleading-claims-of-contaminating-air-in-mpumalanga-20043289>

³⁷ <https://www.fin24.com/Economy/eskom-pollution-kills-almost-2000-people-a-year-report-20190312>

³⁸ Eskom. Applications for suspension, alternative limits and /or postponement of the minimum emissions standards (MES) compliance timeframes for Eskom's coal and liquid fuel fired power stations. Summary Document. November 2018.pgs 21,23

the next four years, renewable energy will be cheaper than Eskom coal generation. This means that as we move forward, proportionally increasing the amounts of renewable energy will mitigate the extent of future price increases of electricity.

Peakers

Eskom describes how it needed to run the peaker plants harder than anticipated.³⁹

“With an increasingly tight capacity situation, compounded by the lower REIPPP output than assumed, the System Operator was required to utilise more diesel generation (from the Eskom fleet as well as the DoE peaker)”. In the previous section, Eskom describes how it prevented the REIPPs from putting power into the grid and now it acknowledges that Eskom (the system operator is inside Eskom) needed to use more diesel because of this.

This requires a fair stretch of logic to understand the reasoning behind this.

Climate Change

Eskom describes how climate change related events such as cyclone Idai and the drought caused an unexpected loss of imported power.⁴⁰ We would argue that such events are a salient reminder of the reality of climate change and that such increasing droughts and storms are predicted in the future. We would also argue that Eskom (who participates in climate change discussions) knew about the drought and should have an adaptation strategy in place. Failure to do so might be regarded as negligence or incompetence but cannot be attributed to ignorance.

In this regard, it is worth providing Eskom’s adaptation response presented in 2011:

“As such, the negative impacts of climate change will become a reality to which we must adapt in order to sustain our business. Adaptation risks in South Africa include an increased number and severity of droughts and floods, human settlement and, thus, infrastructure movements, and risks to staff and customers. Short-term adaptation measures include the consideration of dry-cooling at our new power stations, thus reducing water consumption by approximately 90%. The trade-off is an efficiency loss. Medium- to long-term considerations include improving the resilience of our infrastructure and staff by incorporating adaptation issues into long-term planning and risk mitigation strategies. This requires modelling of impacts and the development of robust strategies that will reduce the overall cost of adaptation and minimise operational disruptions”⁴¹.

Eskom has known that operational disruptions might occur due to climate change and had acknowledged the need to adapt as far back as 2011.

³⁹ Section 10.4.1.3 *DOE Peaker*, in Eskom RCA 2018/19 application, page 60.

⁴⁰ Section 11.2 *Cross-border purchases of electricity*, in Eskom RCA 2018/19 application, page 61.

⁴¹ Eskom presentation at COP17. Available at:

<http://www.eskom.co.za/OurCompany/SustainableDevelopment/ClimateChangeCOP17/Documents/COP17articles222-02.pdf>

5. Coal costs

Eskom describes its different coal contracts, and the varying reasons for the difference in the amount and cost of coal supply to different power stations, together with examples of breakdowns which led to the need for additional short-term supply.

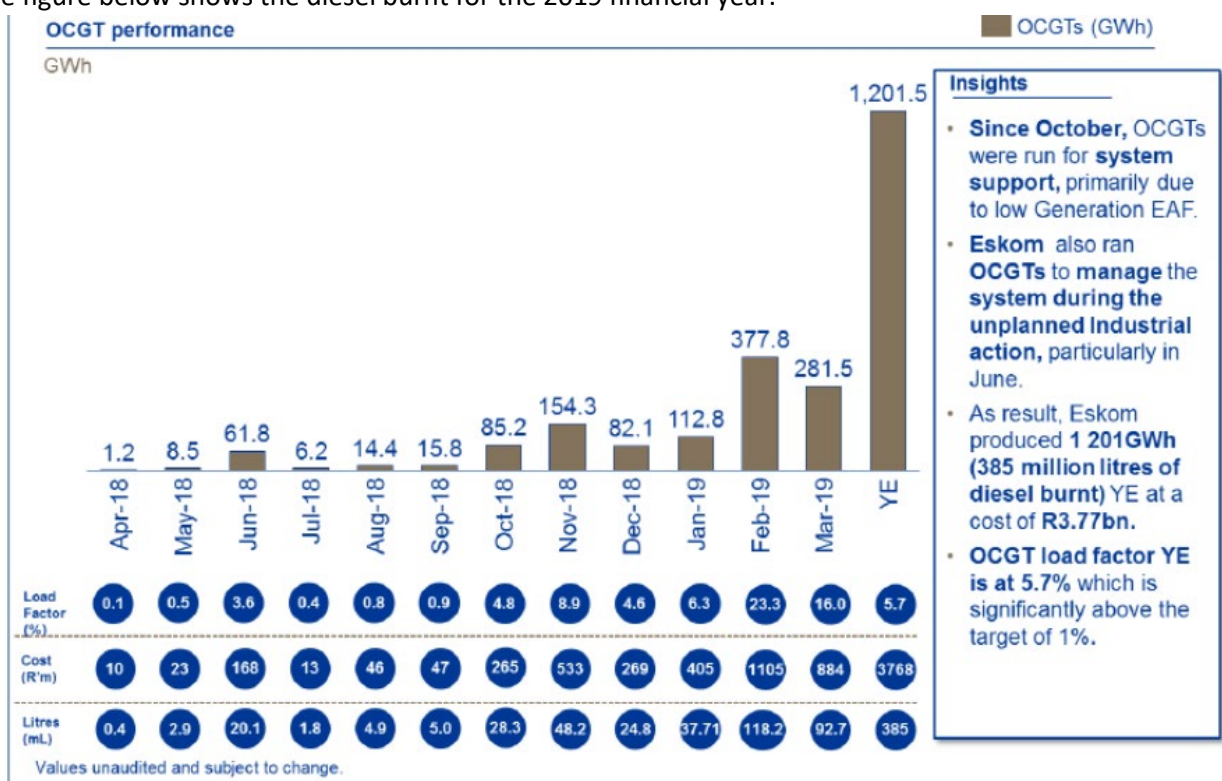
Media articles, for example, a Mail & Guardian article of October 2019, provides an exposé of how different companies are paying different prices for different qualities of coal. An extract: “The taxpayer will be burdened with a roughly R10-billion bill over the next six years, because Eskom has failed to negotiate a standard price for the coal it burns to keep the lights on”⁴².

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.

Eskom’s citing of issues such as the lack of funding for extension of mines, or the extended period of negotiation over other coal contracts are also not unforeseen costs. Is it therefore prudent for consumers to bear the cost of Eskom’s failure to manage such risks? We think not.

Issues such as conveyor breakdowns or community activism could be looked at differently. In our view, the breakdowns are part of the lack of maintenance saga, taking place over years. The failure of Eskom to plan efficiently for such maintenance and to run the fleet into the ground under pressure from the shareholder is understood. However, why should the consumers pay for this?

The figure below shows the diesel burnt for the 2019 financial year.⁴³



⁴² Thanduxolo Jika and Sabelo Skiti. 11 October 2010. *The high price of coal connections*. Mail & Guardian. Available at: <https://mg.co.za/article/2019-10-11-00-the-high-price-of-coal-connections/>

⁴³ Figure 7: Gas Turbine usage for FY 2019, in Eskom RCA 2018/19 application, page 92.

Eskom had planned to use 345 million litres of diesel and ended up using 3 768 million litres. This is more than a ten-fold increase.

Due to failure in coal supply and failure in maintenance plans, Eskom burnt ten times more diesel than it planned to. Was this the most efficient means of ensuring security of supply? Was this a prudent cost? Given the maintenance failures, it is clear that Eskom should have foreseen the potential of a shortage of supply. What alternative did it have? At this point, it might not have had any but as it could have been predicted, is it fair to ask consumers to shoulder the burden for Eskom's lack of planning?

6. Staff costs

Eskom details some of the staffing issues on page 128 of the RCA application.

The variances include the awarding of higher than inflation salary increases, reduction in overtime and the payment of non-bonuses! "The bonus cost is R100m lower than the application due to the non-payment of performance bonus and it includes a once off cash payment of R10 000 after tax paid to non-managerial staff which amounted to R24m." ⁴⁴ (page 128 of the RCA).

In the situation that Eskom finds itself in it could be assumed that working to fix power stations that break down, and addressing unplanned outages would lead to increases in overtime to speed up the repair process. However, given that Eskom has performed sub-optimally, should any contractual obligation to pay a bonus by another name, be passed through to the customers? OUTA does not believe that rewards for bad performance are an efficient cost, and queries how a reduction in overtime would help increase response time to unplanned outages.

Eskom has had 11 CEOs⁴⁵ and six Board chairpersons⁴⁶ over the last decade. It is difficult to see how a person who has not overseen an entire year production and financial cycle could have a sensible idea of strategic interventions apart from the obvious need to root out corrupt practices. South Africa needs to give the current team time to come up with results. However, neither the public nor Eskom can afford to operate in the dark. Eskom needs to communicate honestly with its customers, on progress and the tough choices that are needed to make progress. If we need four hours of loadshedding every day for a year, then don't tell us it is zero and then plunge us into darkness. South Africa needs consistency around which resilience can be built both in the public and private sector.

⁴⁴ Eskom RCA 2018/19 application, page 128.

⁴⁵ Eskom CEOs since 2010: Mpho Makwana, Brian Dames, Collin Matjila, Tshediso Matona, Brian Molefe, Matshela Koko, Johnny Dladla, Sean Maritz, Phakamani Hadebe, Jabu Mabuza, Andre de Ruyter. See list at <https://twitter.com/AntonEberhard/status/1215973530329849856>

⁴⁶ Eskom board chairs since 2010: Mpho Makwana, Zola Tsotsi, Ben Ngubane, Zethembe Khoza, Jabu Mabuza, Malegapuru Makgoba. See list at <https://twitter.com/AntonEberhard/status/1215950674049019905>

7. Medupi and Kusile

Cost of building Medupi and Kusile have soared while the builds have been delayed. This points to incompetence by Eskom management.

In August 2007, a few months after construction on Medupi started, Eskom said Medupi would cost about R80bn, the last unit would be commissioned in 2015 and it would have an operational life of 50 years.

Construction on the 4 800MW Kusile started in April 2008. The last unit was due to be commissioned in 2016. In January 2015, Eskom estimated the costs for Kusile as R82bn excluding interest, with a total cost of R118.5bn.

In 2016, then Minister Lynne Brown told Parliament that Medupi's cost excluding interest was R105bn and R134.2bn including interest during construction, while Kusile's cost excluding interest was R118.5bn and R167.2bn including interest during construction. These costs included escalation costs of R12.69bn for Medupi and R22.7bn for Kusile.

Eskom's Integrated Report 2019 lists the costs and progress: "To date, Medupi has spent 89% of its R145 billion budget, and construction is 95% complete. Kusile has spent 87% of its R161 billion budget, and construction is 87% complete." The cost of fixing the six major plant defects at the pair was estimated at R7.2bn, some of which would be recoverable from contractors. Eskom said it was not financially viable to stop construction as this would cost R140bn (R40bn in claims and penalties, and R100bn for impairing the asset in the regulatory asset base with the R100bn loan to be repaid immediately).

In August 2019, Eskom's figures were questioned by energy expert Chris Yelland, who said those totals did not include all the costs, and totals would be more likely to be R234bn for Medupi and R226bn for Kusile.

8. Financing the gap

Eskom's MYPD4 application outlines the support provided by the government by that point. "Eskom initially received support from government in the form of a R60bn shareholder loan which was converted into equity in 2015 and in the form of a further R23bn equity injection completed in March 2016. Government also approved R350bn worth of guarantees on Eskom's debt of which Eskom had drawn on R218bn worth by 2017/18 (the agreement is to be extend to 31 March 2023). Government guarantees of SOE debt rose from R65bn in 2008 to a total of R445bn in 2017 and 77% of this is for the electricity sector which also covers Eskom's power purchase agreements with IPPs."⁴⁷

⁴⁷ Eskom Revenue Application: Multi-Year Price Determination (MYPD 4) FY2019/20 – 2021/22. September 2018. Page 97. Available at: <http://www.nersa.org.za/Admin/Document/Editor/file/Consultations/Electricity/Notices/Eskom%20Summary%20MYPD4.pdf>

We do not deny that due to past practices, Eskom will need further financial support as it restructures and transforms to modernity. Eskom has had the ability to raise money from loans from the shareholder, and additional equity from the shareholder and through the tariffs (using the MYPD methodology). NERSA's latest MYPD methodology, if properly applied, should limit variances and enable NERSA to monitor Eskom more closely.

The RCA is an additional mechanism for dipping into a slush fund in a sense and it is the most iniquitous in terms of destabilising impacts of varying electricity prices. OUTA therefore recommends that the RCA be reviewed and scrapped and for such expenses that Eskom generally needs a further bailout, it can approach the shareholder. Where such incidents are requested, a precautionary approach would suggest that NERSA be asked to hold public hearings and to advise on the feasibility and viability of such bailouts.

There have been numerous reports of shareholder interference which Eskom has cited as partly responsible for its situation. However, this is not something new. Eskom has admitted it had to keep the lights on for the 2010 World Cup, or over Christmas etc.

In 2019, in parliament, the minutes reflect that the Board was experiencing interference: "If the Board could take decisions without political interference, she could tell the Committee what was needed. Eskom needed to tell SAs that Eskom needed to load shed for the next eight months. She understood that load shedding cost the economy R2 billion a day. Eskom was sitting with units that were nearly at the end of their lifespan. They would simply stop working because there had been no maintenance and they had not been replaced. Decisions had been taken in the past to keep the lights on at all costs because the country was nearing elections."⁴⁸.

Such political pressure is not unknown and, could we argue, have been foreseen and therefore is not a prudently occurred cost.

We would acknowledge that Eskom is in a difficult place if it refuses to bow to political pressure and we would argue that politicians have been understandably concerned and felt it was necessary to intervene in what had become an instrument of state capture, not an energy supply company.

9. Conclusions

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.

Without going into a page by page analysis of the 151 pages of the RCA application, or its MYPD 4 base document, we have attempted to demonstrate that in the main, Eskom should have known about the additional costs it incurred. It is our contention that Eskom fails to do its homework but continues to forecast its performance and revenue year on year with unproven assumptions. The

⁴⁸ Parliament's Standing Committee on Appropriations. Meeting with Eskom Executive Board on challenges facing the power utility. 29 October 2019. <https://pmg.org.za/committee-meeting/29188/>

RCA mechanism means that Eskom is not accountable for its bad planning, and leads to increased suffering for society.

In the RCA application, Eskom points to the risks of renegotiating coal contracts: “Additionally, if contracts are regularly reopened, the purpose of having a contract is undermined and results in negotiating in poor faith which could attract further risk”.⁴⁹

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, and which appear to civil society to amount to blackmail: “if we don’t get an increase, the lights will go out”. This is an unsustainable approach to electricity provision and has certainly “attracted further risk” to the economy and society in general.

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 and this can only be positive for South Africa going forward.

Appendix A

Is NERSA following its own Methodology?

According to NERSA’s Multi-Year Price Determination Methodology, the following objectives are to be achieved in regulating Eskom tariffs:

The following objectives are adopted in developing the regulatory methodology for the MYPD⁵⁰:

- *To ensure Eskom’s sustainability as a business and limit the risk of excess or inadequate returns; while giving incentives for new investment, especially in generation;*
- *To ensure reasonable tariff stability and smoothed changes over time consistent with the socio-economic objective of the Government;*
- *To appropriately allocate commercial risk between Eskom and its customers;*
- *To provide efficiency incentives without leading to unintended consequences of regulation on performance;*
- *To provide a systematic basis for revenue/tariff setting;*
- *To ensure consistency between price control periods;*

According to 4.1 (Methodology), the formula for generation charges includes:

⁴⁹ Eskom RCA 2018/19 application, page 66.

⁵⁰ NERSA. *Multi-Year Price Determination Methodology – MYPD4 methodology 2018.*

Efficient primary energy costs (inclusive of non-Eskom generation)

Allowances for service incentives

In assessing the valuation of assets, the regulator (according to the policy position 1 of the Electricity pricing policy) sets the revenue requirement "at a level which recovers the full cost of production, including a reasonable risk adjusted margin or return on appropriate asset values. The regulator, after consultation with stakeholders, must adopt an asset valuation methodology that accurately reflects the replacement value of assets of those assets such as to allow the electricity utility to obtain reasonably priced funding for investment: to meet Government defined economic growth. b. In addition, the regulatory methodology should anticipate investment cycles and other trends to prevent unreasonable price volatility and shocks while ensuring financial, viability, continuity, fundability and stability over the short, medium and long term assuming an efficient and prudent operator."pg 10.⁵¹

In calculating allowed revenue for operation costs, the regulator uses the following criteria.

5.4.1 Expenses must be incurred in the normal operations of production and supply of electricity, including an acceptable level of refurbishment, repairs and maintenance costs;

5.4.2 Expenses must be prudently and efficiently incurred after careful consideration of available options;

5.4.3 Expenses must be incurred in an arm's length transaction. Eskom must have a competitive procurement policy and demonstrate to the regulator that it has been strictly adhered to in its procurement processes;

Primary energy costs have the following criteria:

The qualifying criteria for allowed primary energy costs are the same as for operating expenses. Only efficient costs will be allowed.

Coal transport costs incurred as a result of coal purchased from coal sources remote from the power stations are included in primary energy cost.

Provision has been made for a pass-through of prudently incurred primary energy costs..(pg 12)

The primary energy costs must be based on central estimates of power generation volumes and prices and be consistent with the wholesale power sales budget.

In evaluating disruptions to the distribution system, the following criteria will apply:

Incentives payable to Eskom should not be larger than the value of improved performance, and should also not be less than the cost to achieve it; • The incentive targets set need to have relevance to the value of the improved performance; • Incentives/penalties should be capped in order to limit the exposure of customers to higher prices;

On assessing pass-through rules, the regulator puts the following rules:

51

<http://www.nersa.org.za/Admin/Document/Editor/file/Electricity/Legislation/Methodologies%20and%20Guidelines/MYPD%20regulatory%20methodology%20-%20%2020%20Nov%20 2 .pdf>

The other primary energy costs (nuclear, hydro, other costs) are considered to be stable and less risky and are therefore not allowed as pass-through. It is considered that Eskom must be able to reasonably accurately forecast these costs. (pg 24).

Paragraph 6.4 (pg concerns the regulatory clearing account (RCA):

The RCA is used to debit/credit the allowable portion of coal costs variances as calculated through the PBR formula and all other costs variances that have not been dealt with in the MYPD mechanism.

The point of contention over recent years is what NERSA has considered “prudent” costs. These relate specifically to “prudently incurred primary energy costs” (section 17.1.1.2) and “prudently incurred over or under-expenditure on operating costs” (section 17.1.1.4).