

OUTA

ORGANISATION UNDOING TAX ABUSE



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Karpowerships: No permits, no clarity, no value, no thanks

Response to applications by Karpowership for generation licences for floating power plants at Richards Bay, Coega and Saldanha Bay

Submission by the Organisation Undoing Tax Abuse to the National Energy Regulator of South Africa

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1. Prelude

- 1.1 The Organisation Undoing Tax Abuse (OUTA) hereby makes its submission in response to the National Energy Regulator of South Africa's (NERSA) call for public comment in respect of applications by Karpowership, its subsidiaries and/or associate companies for three generation licences.
- 1.2 The applications in question relate to three floating power plants (power ships) and associated floating storage and regasification units (FSRUs) at Richards Bay, Coega and Saldanha Bay.
- 1.3 The projects, which have still not achieved financial closure, would be procured in terms the Risk Mitigation Independent Power Producer (RMIPPP) programme of the Department of Mineral Resources and Energy (DMRE).

2. Contextual background

- 2.1 By way of introduction, OUTA is a proudly South African non-profit civil action organisation, comprising of and supported by people who are passionate about improving the prosperity of our nation. We envision a prosperous country, with an organised, engaged and empowered civil society that ensures responsible use of tax revenues.
- 2.2 Part and parcel to OUTA's mission is the challenging of legislation and regulatory environment, this includes participating and engaging with government where public interest is concerned, as is the case with Karpowership's pending applications.

OUTA strongly opposes the applications by Karpowership, its subsidiaries and/or associate companies for generation licences for floating storage and regasification units at Richards Bay, Coega and Saldanha Bay

3. OUTA's position on Karpowership's generation licence applications

- 3.1 OUTA strongly opposes the applications by Karpowership, its subsidiaries and/or associate companies for generation licences for the three FSRUs at Richards Bay, Coega and Saldanha Bay, for the reasons detailed herein.
- 3.2 The choice of energy mix and subsequent determinations in terms of Section 34 of the Electricity Regulation Act, 2006 (ERA) including the projects that make up the so-called emergency RMIPPP programme of the DMRE will impact the lives of South Africans today and in future generations.
- 3.3 OUTA therefore submits that the premature consideration of the Karpowership project licence applications through these public hearings and/or the granting of generation licences for these projects by NERSA in these circumstances would be irregular and may result in any decision taken by NERSA to be potentially reviewable in terms of the Promotion of Administrative Justice Act, 2000 (PAJA). OUTA appreciates that NERSA is obligated to consider such applications as prescribed by section 4 of the ERA. However, such obligation should not be seen with disregard to NERSA's mandate as set out in section 2 of the ERA.
- 3.4 Should NERSA make the wrong decisions by not applying its mind by prematurely considering and/or granting the generation licences sought by Karpowership, and the matter is not challenged, South Africans will be burdened with expensive and time-consuming litigation and/or electricity generation sources for two decades. This will impact negatively on the electricity price in South Africa, and on climate change, air pollution, water pollution and noise pollution in sensitive coastal eco-systems.
- 3.5 While OUTA's submission will primarily focus on the Karpowership projects of the RMIPPP programme, other submissions will focus on the irrationality of the fundamental approach and specification of the whole RMIPPP programme in its entirety.
- 3.6 In particular, OUTA supports the submission by Clyde Mallinson to this call for public comment and input in respect of generation licences for the RMIPPP programme, in which he explains that the fundamental and whole approach taken by the RMIPPP programme was irrational, technically lacking and not in the interests of electricity customers and South Africa as a country.

4. Environmental authorisation for the three Karpowership projects has been denied

- 4.1 It is common cause that the applications for environmental authorisation by Karpowership for the three projects in question have been rejected and denied by the Department of Forestry, Fisheries and the Environment (DFFE).
- 4.2 The three applications for environmental authorisation by Karpowership, together with a number of objections raised by various civil society organisations, the subsequent rejection of the Karpowership applications for environmental authorisation by DFFE and its reasons for decision, are all in the public domain and available to NERSA and will therefore not be repeated here. OUTA cautions NERSA to take this critical information into consideration when making a decision on Karpowership's applications. OUTA reiterates that should this relevant information not be taken into consideration, any subsequent decisions taken may be potentially reviewable in terms of PAJA.
- 4.3 It is noted that Karpowership and other parties have lodged internal appeals against the denial by DFFE to grant environmental authorisation for the Karpowership projects. However, there is no indication at this stage of when the internal appeal by DFFE will be heard, or when the final outcome from DFFE will be announced. Furthermore, whatever the final ruling of DFFE, it is inevitable that the matter will be taken on review in the courts. Again, OUTA submits that the entertainment of the applications in question are premature in the absence of an outcome to the aforementioned process.
- 4.4 It is thus clear that environmental authorisation of the Karpowership projects will continue indefinitely.

Karpowership was refused environmental authorisations for all three projects

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- 4.5 The public and affected stakeholders require the final decision by DFFE and/or the courts, and the reasons for their final decisions, in order to understand the issues and to enable meaningful comment and input in relation to environmental implications of these projects. In the absence of a final outcome to the aforementioned processes, NERSA's call for public comment on Karpowership's applications borders on a mere tick-box exercise.
- 4.6 In light of the above alone, it is therefore irrational and superfluous for NERSA to consider and/or grant the Karpowership generation licence applications at this premature stage, including through this public participation process.
- 4.7 Even if NERSA's contends that the public participation process is justified, a situation is created whereby all inputs received from the public will lack reference to the crucial information that impacts NERSA's ultimate decision. Thus, the relevant information will not be subjected to public scrutiny, thereby rendering NERSA's decision and any ancillary public participation processes procedurally unfair.

5. Evidence of port authority permits is not included in Karpowership licence applications

- 5.1 The Karpowership project generation licence applications do not include evidence that the relevant port authorities have agreed or will agree to provide permits for the mooring of floating powerships and FSRUs in the harbours of Richards Bay, Coega and Saldanha Bay for the next 20 years.
- 5.2 NERSA's own generation licensing procedures require that evidence of such permits or port authorisations should be included with such applications for generation licences.
- 5.3 Furthermore, there are significant differing legal opinions in the public domain by major legal companies such as Webber Wentzel and Pinsent Masons as to the powers of the Transnet National Ports Authority (TNPA) as a subsidiary of Transnet to grant such permits or authorisations.

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- 5.4 It is clear that any such port authorisations to Karpowership will face a barrage of legal challenges, and that this matter will only be finally clarified in the courts. Therefore, NERSA cannot assume that the lack of such authorisations is permissible in the absence of legal clarity.
- 5.5 The public and affected stakeholders require clarity in respect of port authorisations in order to understand the issues and to enable meaningful comment and input to NERSA on the economic and other impacts and implications of mooring the floating powerships and FSRUs in South African harbours for 20 years.
- 5.6 In light of the above alone, it is therefore irrational superfluous for NERSA to consider and/or grant the Karpowership generation licence applications at this premature stage, including through this public participation process.

6. Proof of gas pipeline authorisation is not included in the Karpowership licence applications

- 6.1 The Karpowership project generation licence applications do not include evidence that NERSA, as the gas pipeline regulator, has agreed or will agree to provide licences or permits for pipelines to transport liquified natural gas (LNG) from shipping tankers to the FSRUs, and to transport gas from the FSRUs to the floating powerships in South African waters.
- 6.2 NERSA's own generation licensing procedures require that evidence of such gas pipeline permits, licences or authorisations should be included with such applications for generation licences.
- 6.3 The public and affected stakeholders require clarity in respect of gas pipeline authorisations in order to understand the issues and to enable meaningful comment and input to NERSA on the impacts and implications of such gas pipelines in South African waters for 20 years.

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- 6.4 In light of the above alone, it is therefore irrational and superfluous for NERSA to consider and/or grant the Karpowership generation licence applications at this premature stage, including through this public participation process.

7. Evidence that Eskom’s board will agree to PPAs is not included in Karpowership licence applications

- 7.1 The Karpowership project generation licence applications do not include evidence that the Eskom board has agreed or will agree to enter into power purchase agreements (PPAs) between the Karpowership IPPs as generators, and Eskom as off-taker for the electricity generated, for 20 years.

- 7.2 On the contrary, reports indicate that Eskom is expressing deep reservations about entering into PPAs with the Karpowership IPPs for the next 20 years. In this regard, OUTA wishes to emphasise NERSA’s role as per section 2(b), (e) and (g) of the ERA, which reads as follows:

“(b) ... [To] ensure that the interests and needs of present and future electricity customers and end users are safeguarded and met, having regard to the governance, efficiency, effectiveness and long-term sustainability of the electricity supply industry within the broader context of economic energy regulation in the Republic.

...

(e) promote the use of diverse energy sources and energy efficiency;

...

(g) facilitate a fair balance between the interests of customers and end users, licensees, investors in the electricity supply industry and the public.”

- 7.3 By not taking the absence of clarity on PPAs into consideration, NERSA will effectively disregard its own mandate should a decision be taken to grant the licences in question.

- 7.4 NERSA’s own generation licensing procedures require that evidence of PPAs, or at least agreement by the Eskom board that Eskom as off-taker will enter into such PPAs, should be included with such applications for generation licences.

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- 7.5 The public and affected stakeholders require clarity in respect of Eskom’s agreement or refusal to enter into such PPAs, together with Eskom’s reasons, in order to understand the issues and to enable meaningful comment and input to NERSA on the economic, contractual and other implications of such PPAs with Eskom, as the national electricity utility, for 20 years.
- 7.6 In light of the above alone, it is therefore irrational, premature and unnecessary for NERSA to consider and/or grant the Karpowership generation licence applications at this stage, including through this public participation process.

***Who will buy the Karpowership electricity?
There’s no power purchase agreement with Eskom,
and Eskom doesn’t seem keen to sign up even if it
could afford it***

8. Criminal investigation by DFFE of Karpowership environmental authorisation application

- 8.1 It has been widely reported and is in the public domain that the Green Scorpions at the DFFE are investigating potentially criminal conduct relating to the extraordinary environmental authorisation granted to Karpowership in June 2020.
- 8.2 This authorisation, just before the RMIPPP tender was announced, exempted Karpowership under an emergency provision of National Environmental Management Act, 1998 (NEMA) from having to undertake environmental impact assessments (EIAs) for its projects, purportedly because it would provide emergency power to combat Covid-19.

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- 8.3 DFFE subsequently revoked the exemption on the basis that the Department had been misled. This forced Karpowership to reapply, this time with complete EIAs for all three of its RMIPPP projects. But DFFE has since refused to grant environmental authorisation sought in respect of these applications.
- 8.4 The public and affected stakeholders require clarity in respect of the subject and outcome of the investigation by the Green Scorpions, and any resulting criminal charges that may arise, in order to understand the issues and legalities, and to make meaningful comment and input to NERSA on the behaviour and actions of Karpowership, its subsidiaries and/or associate companies.
- 8.5 While this investigation is in progress, which may lead to criminal prosecution, it is therefore irrational and premature for NERSA to consider and/or grant the Karpowership generation licence applications at this stage, including through this public participation process.

9. Legal challenge by DNG Energy disputing award of preferred bidder status to Karpowership

- 9.1 It has been widely reported and is in the public domain that DNG Energy is conducting a legal action against the award of preferred bidder status to the three Karpowership projects under the RMIPPP programme.
- 9.2 DNG Energy alleges in its court papers that procedural irregularities, conflicts of interest and corrupt activities resulted in the improper award of preferred bidder status to the three projects to Karpowership, its subsidiaries and/or associate companies.
- 9.3 DNG Energy is seeking to have itself substituted as the preferred bidder for the three projects in place of Karpowership, its subsidiaries and/or associate companies. The court hearing was set down for mid July 2021 but was delayed and is now set down for 9, 10 and 13 September 2021.

DNG Energy says the tender process had procedural irregularities, conflicts of interest and was corrupt, so the preferred bidder award was improper

- 9.4 The public and affected stakeholders require clarity in respect of the subject and outcome of this court action by DNG Energy in order to understand the issues and legalities, and to enable meaningful comment and input to NERSA on the award of preferred bidder status of Karpowership, its subsidiaries and/or associate companies.
- 9.5 In light of the above alone, while this court action is in progress and while judgement has yet to be made, it is therefore irrational and premature for NERSA to consider and/or grant the Karpowership generation licence applications at this stage, including through this public participation process.

10. Investigation by Portfolio Committee on Mineral Resources and Energy

- 10.1 It has been widely reported and is in the public domain that the parliamentary Portfolio Committee on Mineral Resources and Energy has taken legal opinion on its right to initiate a parliamentary inquiry into the award of preferred bidder status to the three Karpowership projects under the RMIPPP programme, and other issues arising.
- 10.2 It has also been widely reported and in the public domain that Parliament's legal advisors have indicated that the parliamentary Portfolio Committee on Mineral Resources and Energy does indeed have this right and intends to conduct such an investigation.
- 10.3 The public and affected stakeholders require clarity in respect of the subject and outcome of the inquiry by the Portfolio Committee on Mineral Resources and Energy in order to understand the details, and to make meaningful comment and input to NERSA on the licence applications for the three Karpowership projects.

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- 10.4 In light of the above alone, until the investigation by the Portfolio Committee on Mineral Resources and Energy is completed, it is therefore irrational and premature for NERSA to consider and/or grant the Karpowership generation licence applications at this stage, including through this public participation process.

11. Financial closure of the Karpowership projects has not and may never be reached

- 11.1 During the announcement of the preferred bidders for the RMIPPP programme by the Mineral Resources and Energy Minister Gwede Mantashe on 18 March 2021, the Minister indicated a “*non-negotiable*” date for financial closure of the RMIPPP projects, including the Karpowership projects, of 31 July 2021.
- 11.2 Under these circumstances, the date of 19 August 2021 would have been perfectly appropriate for public hearings to consider the generation licence applications of the successful bidders under the RMIPPP programme.
- 11.3 However, in the event, for many of the reasons indicated above, none of the successful bidders and projects announced by the Minister on 18 March 2021, including the three Karpowership projects, achieved financial closure by the deadline of 31 July 2021. The deadline date for financial closure has thus been extended to 30 September 2021 by the IPP Office of the DMRE.
- 11.4 Despite financial closure now being required by 30 September 2021, there is a likelihood that the date for financial closure of the Karpowership projects will be further extended, in due course, well beyond the revised deadline date. Indeed, it is quite likely that financial closure may in fact never be achieved for the Karpowership projects.

It is quite likely that financial closure may never be achieved for the Karpowership projects

- 11.5 In these circumstances, and until financial closure is achieved, it makes no sense, and it is irrational and premature for NERSA to consider and/or grant the Karpowership generation licence applications at this stage, including through this public participation process.

12. The business case, tariff rates and price variation of the Karpowership projects

- 12.1 It is noted that the tariff rates bid by Karpowership, its subsidiaries and/or associate companies, for electricity to be delivered into the Eskom grid by these three projects in the RMIPPP programme, were not the lowest, nor were they significantly different from those of several of the other bidders at the date of bid.
- 12.2 However, there is a very significant difference in the cost price variation that will be applicable to the three Karpowership projects as compared to that any of the other projects of the RMIPPP programme, over the 20-year contract period.
- 12.3 For all the non-Karpowership projects of the RMIPPP programme, imported fuel costs (LNG, diesel, etc.) form a very low percentage of the tariff rate. The tariff rate is therefore largely indexed only to the South African consumer price index (CPI) over the 20-year contract and is therefore essentially fixed in real terms over this period.
- 12.4 The Karpowership projects, on the other hand, use fully imported LNG fuel, which makes up an estimated 60% of the tariff rate. Similarly, the powerships themselves are leased from the

Turkish Karpowership holding company, with the associated lease costs thus being another fully imported cost component, making up an estimated further 25% of the tariff rate.

- 12.5 Thus, an estimated 60% of the tariff rate is indexed to US Dollar market price of LNG, the US Dollar to ZA Rand exchange rate and the carbon price, with massive upside potential of the tariff rate over the next 20 years. A further estimated 25% of the tariff rate is likely to be indexed to one or other foreign currency, with little or no transparency as to the details.
- 12.6 Very significant portions of the three Karpowership licence applications, particularly those portions disclosing details and make-up of the business case, tariff rates and price adjustment formulae described above, have been redacted and are not available to the public or affected stakeholders.
- 12.7 However, it is clear that the Karpowership project bid tariff rates, which are quite close to those of the non-Karpowership projects at the date of bid, may be significantly different (i.e., higher) than those of the non-Karpowership projects over the course of the 20-year contract period.

Karpowership is not the cheapest option and we may find that it becomes unaffordably expensive, as 60% of the tariff is linked to the US dollar price of gas

- 12.8 Yet there is no information available to the public and affected stakeholders as to how the DMRE and its IPP Office evaluated the impact of price variations of the tariff rates bid for the three Karpowership projects over the 20-year contract period, or the business case of these projects.
- 12.9 OUTA has noted that documentation made available to the public, which to some extent relate to the business case, has been provided in a redacted form. OUTA contends that any inputs made concerning redacted documentation is meaningless.
- 12.10 Thus, details of the tariff rate variation formulae and business case of the Karpowership projects over the 20-year contract, and the how the IPP Office accounted for the differences in tariff rate variations between Karpowership and non-Karpowership projects, is neither transparent nor visible.

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- 12.11 In these circumstances, it is impossible and irrational for NERSA to expect the public and affected stakeholders to make any meaningful comment and input on the business case and its evaluation by the IPP Office, and therefor on the generation licence applications themselves, for the Karpowership projects, through this public participation process.

How did the Department of Mineral Resources and Energy evaluate the impact of price variations on the tariffs?

13. Conclusion

- 13.1. Any one of the many objections detailed above would stand to disqualify consideration by NERSA of the generation licence applications for the Karpowership projects, including the commencement by NERSA of this public participation process.
- 13.2. Considering the totality of all the objections detailed above collectively, it is indeed astounding that NERSA is seen to be entertaining the Karpowership project generation licence applications, notwithstanding section 4 of the ERA.
- 13.3. The announcement and holding of this public participation process by NERSA to consider the generation licence applications for the Karpowership projects is inconsistent with NERSA's own processes and past practices, where only complete licence applications are considered.
- 13.4. The Karpowership project generation licence applications are far from complete and/or adequate, and many processes detailed above are still underway before any such generation licence application can or should be considered by NERSA.

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- 13.5. The three Karpowership project generation licence applications should therefore be rejected and returned to the applicant(s) pending the completion of the many outstanding and incomplete permissions and processes that are currently underway in respect of these projects.

***The Karpowership licence applications are incomplete,
so NERSA should not even be considering them***

***OUTA calls on NERSA to reject the Karpowership licence
applications***