

**In the matter of the Eskom revenue application to  
NERSA for FY 2018/2019**

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**SUBMISSION BY OUTA**

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***" No longer business as usual "***

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## **The Organisation Undoing Tax Abuse (OUTA)**

OUTA is a proudly South African non-profit civil action organisation, supported and publicly funded by people who are passionate about improving the prosperity of our nation. OUTA was established to reintroduce accountability to government and to challenge the abuse of authority with regards to taxpayers' money in South Africa. We are making this submission as we believe that electricity pricing has a profound affect on South Africa's economy, on the government's spending of taxpayers' funds and on the consumers who have to pay for electricity. We believe that the management of Eskom, a state-owned entity, has participated in or allowed the large-scale looting and mismanagement of its funds, to the direct detriment of South African taxpayers and electricity consumers. We thus regard it as within our mandate to comment on this and oppose Eskom's request for a 19.9% increase in revenue (and thus prices). We ask NERSA to refuse Eskom any increase.

## **EXECUTIVE SUMMARY**

OUTA makes submissions on this matter as follows:

1. **It is too late to save both Eskom and the South African economy so a choice has to be made.**

Eskom as it is cannot survive financially in any plausible future scenario and should be unbundled and restructured before it drags the South African economy down with it. The Eskom grid division together with other non-generation divisions should be safeguarded against implosion to ensure that the country's electricity supply system remains stable. This can be achieved by splitting Eskom into a generation company (Genco) and a distribution company (Gridco) allowing Gridco to be sold off on a sale and leaseback arrangement. NERSA needs to investigate its regulations to identify such an eventuality, as it will come about very fast as Eskom melts down.

2. **Eskom is not an efficient operator and hence is not legally entitled to additional cost recovery.**

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**ORGANISATION UNDOING TAX ABUSE (OUTA)**

Co Reg: 2012/064213/08 NPO #: 124381NPO  
DIRECTORS: Wayne L Duvenage (Chairman), Leopold J J Pauwen,  
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A proper interpretation of the legal framework determining Eskom's cost recovery and NERSA's mandate shows that Eskom may only recover its costs and earn a return if it is "an efficient operator". It is patently no longer an efficient operator and NERSA therefore, in law, has no option but to deny Eskom any additional cost recovery until the enabling legislation is amended or until Eskom returns to being "an efficient operator". Such an outcome is clearly in the interests of the country as it would fast track the urgently required restructuring of Eskom and the electricity sector. This extends to operating efficiency and capital expenditure (capex) efficiency, as inflated asset values are transferred to the Regulatory Asset Base (RAB) and the collusion between Eskom and NERSA in this constitutes fraud.

**3. Eskom is attempting to defraud NERSA and electricity consumers in its revenue application.**

In seeking to perpetuate financing for its inefficient and corrupt business practices, Eskom makes willful misrepresentations in its revenue application, at least three of which could be seen as amounting to attempted fraud and would constitute fraud proper if NERSA grants the revenue application as requested. Should this matter be ignored by NERSA, then OUTA will have no other choice but to consider laying charges of attempted fraud against Eskom and NERSA if this MYPD is endorsed.

**4. Transparency is not negotiable.**

The revenue application is defective as it still does NOT provide adequate transparency, relies on what are now clearly corrupted forecasts, and does not identify how much fraud and corruption has been financed by the electricity consumer since 2005/7 when accelerated corruption commenced. By endorsing this application, NERSA will be granting the Eskom corruptors a 20% increase in revenue that can be stolen.

At the NERSA hearings, NERSA disallowed Eskom's application for less transparency through the exclusion of vital information, and yet crucial information required in the current revenue application was redacted from the published application. Given this state of affairs, OUTA can come to no other conclusion other than that NERSA is not fulfilling its mandate to the people and by default, is acting in collusion with Eskom.

**5. The results of NERSA condonation of price increases over the years.**

The lavish and excessive previous price increases approved by NERSA allowed Eskom to:

- 5.1 Increase staff headcount by 50% without any increase in sales;
- 5.2 Fund a more than R27 billion budget overrun on Ingula;
- 5.3 Fund a more than R65 billion overrun on Medupi;
- 5.4 Fund a more than R50 billion overrun on Kusile;
- 5.5 Increase the cost of coal from Gupta mines by more than R300 per ton;
- 5.6 Waste more than R1.6 billion on McKinsey/Trillian with no value delivered;
- 5.7 Keep McKinsey/Accenture and others on hand on the excuse of turnaround plans or cost cutting since 2005, with no substantive results;
- 5.8 Allowed the Eskom Board to propose and/or condone bonus payouts to Brian Dames (R22 million) and Brian Molefe (R30 million) when the performance of Eskom has deteriorated;
- 5.9 Spend more than R10 billion on diesel because of fabricated blackouts;
- 5.10 Apply improper management practices and increases in the electricity cost of more than R1.4 trillion to the SA economy since 2005 to fund the capex that should have cost no more than R93 billion;
- 5.11 Decline in efficiency in virtually every sphere of activity;
- 5.12 Implement countless other corrupt and fraudulent practices in areas such as synthetic billing tariffs, household connections to the grid and the rollout of solar heating systems being connected to the grid;
- 5.13 Support the desire to spend billions of rand on a nuclear energy strategy, despite an unjustified premature plan without the rationale of a transparent, informed lowest-cost Integrated Resource Plan (IRP) process being completed; and
- 5.14 Spend more than R1.4 billion per year on the ANC Secretary General's family business for a food contract at Medupi, along with other contracts that feed into the almost

deliberate delays that hinder the completion of this power plant by an estimated five additional years.

6. Electricity pricing anomalies have been exacerbated by NERSA's lack of capacity to regulate Eskom. This is evident from the vast amount of corruption that has gone undetected, both on operating expenditure (opex) and capex. Whilst in theory NERSA should be efficient and capable of monitoring Eskom efficiencies or lack thereof, it is patently clear that NERSA has not been able to fulfill its role effectively, resulting in billions of rand lost to corruption. This has been documented in numerous reports and news articles and is currently under investigation in the parliamentary enquiry by the Portfolio Committee on Public Enterprises.
7. Given the deficiencies in NERSA's capacity to regulate Eskom, together with billions of rand lost to graft, the defects in the regulatory regime and Eskom's flawed or deliberately fraudulent forward projections of growth, it would be better to deny Eskom any increase and to have Eskom justify claims via the Regulatory Clearing Account (RCA) process at a later date.  
8. South Africa's economy can no longer be captured by deliberate and possibly fraudulent over-forecasting, which guarantees Eskom massive price increase (its own projections for price increases run at 20% per year for five years). These increases must be funded by an embattled public with little recourse from an unsympathetic and clearly biased NERSA, which appears collude with Eskom by allowing it to cover up the cost of major corruption.
9. Based on the above, it is our contention that no increase at all is justified under the current circumstances and that NERSA owes the public a full inquiry into lapses in regulation of Eskom.

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## **Part 1: It is too late to save both Eskom and the South African economy so a choice has to be made**

### 1.1 Introduction

South Africa needs an affordable and dependable electricity system to underpin economic prosperity and social welfare. This has traditionally been supplied near-exclusively by Eskom and was traditionally dependable and affordable.

In recent years the system has suffered on both counts, becoming less reliable (with load shedding) while also becoming far more expensive. South Africa has guaranteed Eskom's debts through sovereign guarantees eventually running up to more than R350 billion (with at least R218 billion drawn on this so far), which is more than 20% of the country's annual budget. In addition, Eskom has incurred further debt of some R120 billion.

The bulk of these debts were incurred to fund Eskom's two new mega coal power stations Medupi and Kusile and the pumped storage station Ingula. The cost overruns on these are extreme and run into hundreds of billions of rand. This money, once spent, can only be recovered from the taxpayer or the electricity consumer. These two new coal plants are well less than half complete in terms of functioning units. The shortage of water at Medupi has not been accounted for by Eskom and will result in full commissioning only happening around 2026.

Eskom needs to borrow approximately R240 billion more to complete these power stations. Should this be allowed to happen, they will have approximately R500 billion of debt that will have to be repaid from the electricity tariff. The power from these plants is no longer needed as the country is in a position of over-supply and has several thousands of megawatts (MW) of renewable energy projects ready to build at far lower costs than the projected costs from Medupi and Kusile.

In Eskom's revenue application, Eskom and the National Treasury agree that the country's sovereign credit rating (which is already non-investment grade) would suffer greatly if Eskom were to be further subsidised by NERSA refusing to grant Eskom cost-reflective electricity tariffs. Thus, the consensus is that very high price increases (Eskom intimates five annual increases of 19% each, including the 2018/19 one, while Treasury works on

five x 10%) is the lesser of two evils and that there is no other alternative way forward for South Africa.

NERSA is the regulator and is the authority assessing Eskom's revenue application. It does so in terms of the Electricity Regulation Act (ERA) and Multi-Year Price Determination (MYPD) methodology, stipulating in summary that Eskom can recover its expenses and earn a return if it is shown to be "an efficient operator". NERSA has traditionally interpreted this as meaning that Eskom can recover such expenses as it may have prudently incurred or for which it can be shown to have been an efficient operator. Conversely, NERSA has traditionally denied Eskom recovery of the expenses not prudently or efficiently incurred. The result has been that the burden of these expenses was shifted from the electricity consumers to the taxpayers and ultimately that the country's balance sheet and credit rating were adversely affected.

The present revenue application comes at a time when the country is in a poor and declining economic situation. The consensus between Eskom and National Treasury in the revenue application is that, if NERSA does not allow Eskom to migrate to fully cost-reflective prices, the impact on the economy will be very adverse – worse than a high price increase. However, it does not appear to be within NERSA's mandate to consider the better way forward when assessing whether to allow Eskom to recover its costs.

We are thus in a situation where the execution of NERSA's mandate in the manner it has been traditionally executed would lead to an outcome that is worse for the South African economy even if it is better for the electricity consumer.

For this reason OUTA suggests that a third way forward has to be found and that the manner in which NERSA executes its mandate should be reassessed afresh to determine whether the intention of the legislation has been respected.

1.2 What will happen if we follow the route of continually paying for Eskom’s inefficiency?

Eskom is in favour of moving to price reflective tariffs with a 19% increase and then four more 19% increases to follow as it believes this does less harm to the economy than continued subsidies. National Treasury has modelled annual increases of 10%, not 19%. If Eskom was to get what it wants, this would mean that the average price of electricity sold moves as follows:

|   | 2017 pre application | 2018   | 2019   | 2020   | 2021  | 2022   |
|---|----------------------|--------|--------|--------|-------|--------|
| Tariff c/kWh<br>Eskom wholesale                     | 89.13                | 106.87 | 127.18 | 151.34 | 180.1 | 214.31 |
| Tariff c/kWh<br>Municipal charge to their customers | 197                  | 236    | 283    | 340    | 408   | 490    |

According to Eskom these price increases will cost South Africa **685,000 jobs** by 2022, ie 137,000 jobs per annum (footnote 4 page 117 of the Eskom revenue application). Eskom appears sanguine about this alarming prospect. According to Treasury, the impact on the electricity demand from a five x 10% increase scenario plus inflation thereafter, is that the following sectors defect from the grid to the following extent by 2040:

- 26% of residential sales go off-grid by 2030;
- 34% of mining goes off-grid by 2040;
- 8% of industrial goes off grid by 2040; and
- 1% of commercial goes off-grid by 2040.

It is important to accept that it is highly likely that Eskom will run out of cash and will have to suspend or terminate the building of Medupi and Kusile. An additional R240 billion (approximately) needs to be borrowed to complete the build. As is commonly known, state-owned enterprises (SOEs) like South African Airways find it difficult or impossible to

roll over bonds with government guarantees for amounts below R10 billion. It is thus inevitable that construction will stop unless the government embarks on a significant quantitative easing and abandons inflation targets, to the detriment of the general economy, to cater for the anticipated Eskom bailouts or guarantees.

### 1.3 The utility death spiral

The utility death spiral is the end of a utility through increased prices that destroy demand and thus necessitate prices having to be increased again to make up for the decreased pool of users having to carry the large fixed costs of generating the country's electricity, leading to a continuous repeat of the cycle. It is an international phenomenon, as pointed out recently by a prominent academic:

*The recent misfortunes of Peabody Energy serve as a warning. Innovation towards a low-carbon economy has outflanked large energy behemoths that still depend on fossil fuels. Trying to keep track of the number of households, companies and municipalities that have invested in their own sources of renewable energy has become impossible. The falling cost of photovoltaic generation, the introduction of modular generation capacity, rapid innovation in battery technologies and the ambition of a new generation of energy entrepreneurs has exposed the belief that electricity supply is a natural public good and the exclusive domain of the state. This is no longer so.*

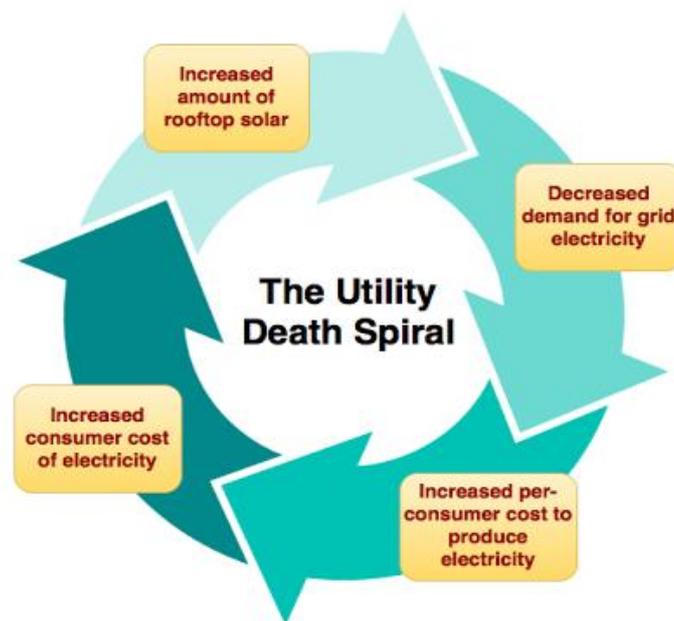
*Within a generation, we will look back on the system under which we relied on; a centrally coordinated, state-owned energy utility in the same light as we regard serfs in the feudal manor relying on their lord for food. The types of technologies being pushed by Musk and others have removed the scale economies that justified state-owned energy utilities in the first place.*

*The shift to cleaner, cheaper and locally controlled electricity was going to happen anyway, but the irony is that Eskom's supply and pricing crises provided just the spur the industry needed to accelerate the quest for alternatives. Necessity mothers invention, but what makes the financial implications of this shift so damaging to Eskom*

*is that its high tariff increase model is effectively causing the loss of clients it desperately needs to keep."*

See: Anton Cartwright <http://www.businesslive.co.za/bd/opinion/2016-08-04-eskom-can-avoid-going-down-an-evolutionary-cul-de-sac/> Cartwright is a green economy researcher at the African Centre for Cities and a Senior Associate of the Cambridge Institute for Sustainability Leadership.

Indeed, there is a fundamental move away from decentralised power generation based on conventional mega-plants selling to consumers. The new world of energy is likely to consist of distributed/embedded generation from a multiplicity of sources by "prosumers" who sometimes generate and sometimes consume energy.



*Source: Google images "Utility death spiral"*

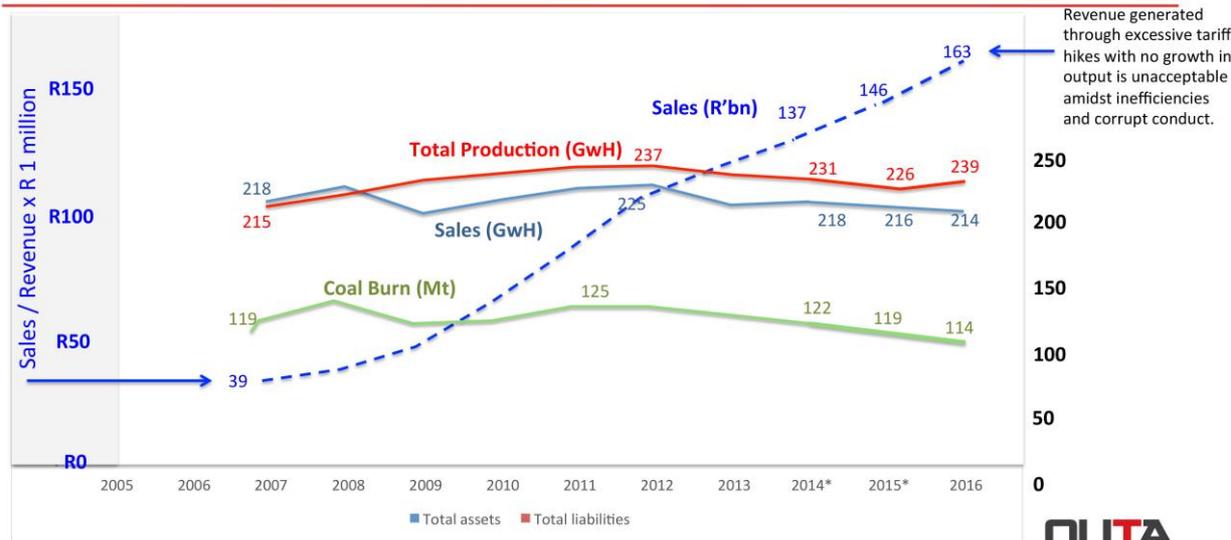
The image above uses increased solar photovoltaic (PV) rooftop as the trigger but the vicious cycle could equally be triggered by increased energy efficiency and/or a lowering of energy-intensive economic activity due to increased electricity prices. In the case of

low-income households it could be precipitated by a return to paraffin lamps and cooking or solar lamps and solar cookers.

It is OUTA’s submission that Eskom is already in the utility death spiral, and the senior management and economists know this, but they choose to hide this knowledge from NERSA and the public (more about this in section 3). Already, electricity demand is some 15% below projections made in the MYPD3 period and the extensive increase Eskom is asking for may not lead to much additional revenue, if any.

Some key Eskom metrics in the two graphics below illustrate the “death spiral” problem.

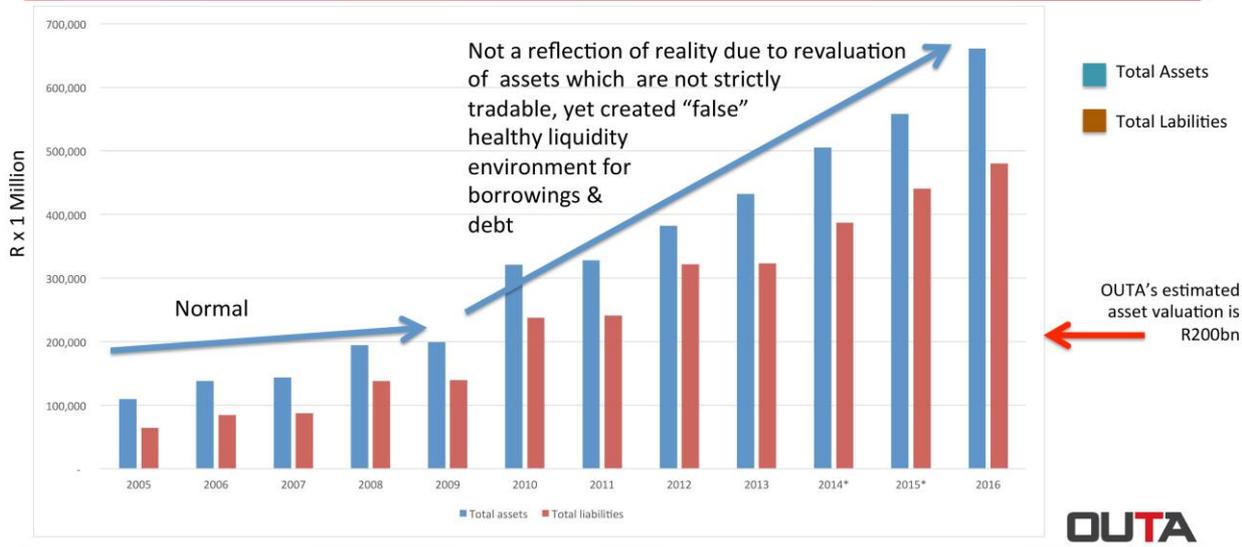
## EXPOSING ESKOM’S REALITY - PERFORMANCE & REVENUE GENERATION



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## EXPOSING ESKOM'S REALITY - ASSETS AND LIABILITIES GROWTH



### 1.4 What will happen if we continue to subsidise electricity prices

Eskom and the National Treasury agree that a continued subsidisation of the electricity price by the taxpayer would have severe adverse impacts on the country's credit rating and would lead to further downgrades, deeper into "junk" territory that would have severe impacts on the national economy. It is important not to fall into the trap of thinking that "Eskom and the government must pay for it themselves". Eskom has no source of money from which to pay (such as savings). Its only possible revenue sources are customers and taxpayers. One or the other pays. The consensus between Eskom and National Treasury is that a high price increase is the "lesser of two evils" and that continued electricity subsidies will have a severe impact on the national economy, even greater than a high price increase.

For purposes of this submission it is accepted that the studies carried out by Eskom and National Treasury are correct and that the continued subsidisation of electricity prices is not a viable option out of the current situation.

1.5 What would have happened to tariffs if the new build projects had not been started?

In order to determine what the price of electricity would have been had there been zero capex spend, we had to identify a year prior to the implementation of excessive price increases to fund the capital expansion programme. We found that 2005 is the first year in which the five-year capex estimate is mentioned. Both the Chairman's Statement and the Directors' Report reference the figure of R93 billion as the total required for capex over the five years to 2010. Thus the reference average price of electricity (in 2005) was 16.04c/kwh. Traditionally, Eskom costs consist of three segments, two of which have fixed costs not affected by inflation (bond coupon costs and plant). The third segment is operating costs, which is the only segment affected by inflation, and of these, more than half of the coal costs are fixed for 40 years at rates below PPI. Hence, it is reasonable to escalate the 2005 price by 1/3<sup>rd</sup> of PPI over the period in order to obtain a benchmark tariff in 2017. Using this approach and using CPI instead of PPI (CPI is around 2% higher than PPI) we get to an efficient tariff of around 20.92c/kwh in 2016 and around 23.25c/kwh in 2017.

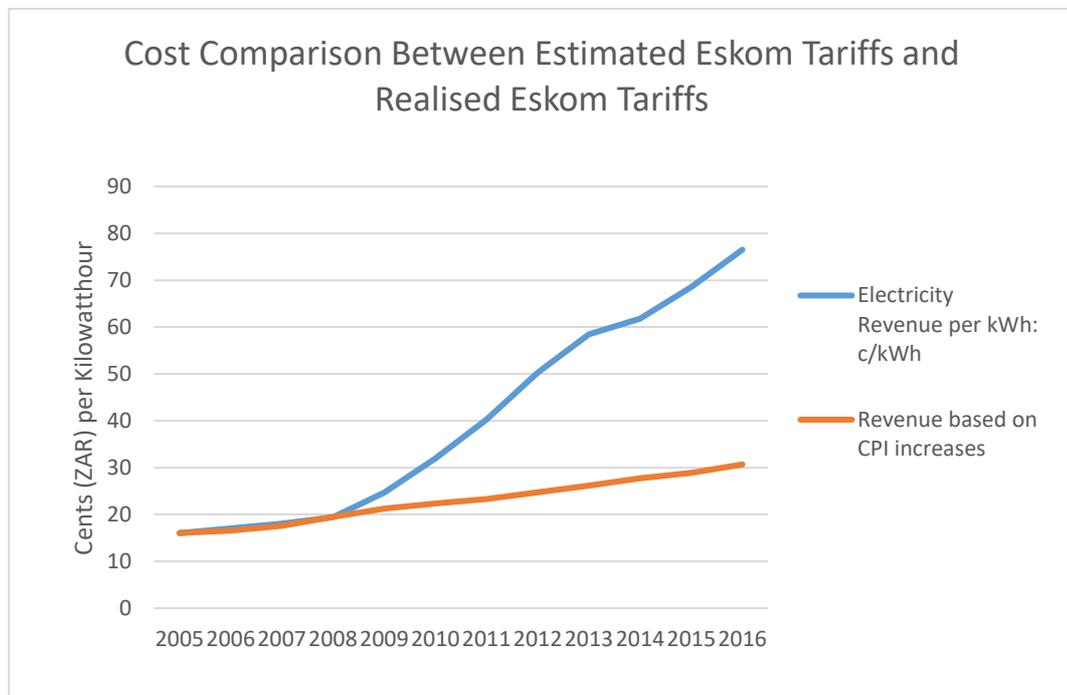
Even if we use the full CPI number (this is really the worst-case scenario) the inefficient tariff should be no more than 30.68c/kwh in 2016 and around 32.5c/kwh in 2017.

Our review of some of the power station tender documents reveals that the R93 billion planned capex was indeed a reasonable estimate of costs. We have calculated that recovering this R93 billion over five years would have equated to adding around 5c/kwh to prices.

Adding that 5c/kWh to the most inefficient tariff above of 32.5c/kWh, means the worst-case scenario should have capped the Eskom tariff at a maximum of 40c/kwh with profits to spare.

The difference between the “Efficient tariff” plus borrowing (which was specifically excluded as an option during 2005/7), plus the capital injection by the government of R83 billion (the provision in 2008 to 2001 of the R60 billion loan and the 2014 conversion of this loan to equity plus the R23 billion bailout) plus the over-recovery via the actual tariff amounts to more than R1.4 trillion. However, neither NERSA nor Eskom bothers to acknowledge that the failure to account for this over-recovery is a massive problem.

OUTA demands that this amount be investigated and traced via a proper forensic audit and fully accounted for, with the perpetrators of what appears to be a massive fraud (seemingly the biggest con job in SA history) be severely dealt with. It is also of concern that NERSA officials have been handsomely rewarded for a job they did **not** do.



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## 1.6 A third way forward – restructuring and unbundling

While Eskom sees only two scenarios for a future South Africa (both with itself at the electricity epicentre) a third option is available where the country moves away from its exclusive reliance on Eskom. While both Eskom’s scenarios are extremely grim and negative, it is OUTA’s submission that the third way will lead to rejuvenation, innovation, and health in our electricity sector.

In February 2017, OUTA provided submissions to the Competition Commission on the desired end state of the electricity sector in South Africa. These are pending in a Competition Commission challenge against Eskom’s abuse of its monopoly position and exclusionary practices. Some change and nuances have been occasioned by developments since the lodging of the above challenge, but the essence of OUTA’s submission remains the same:

- Eskom should be unbundled so that its generation and grid operations become the distinct endeavours of two distinct, state-owned corporate entities. The Department of Energy or the National Treasury should become the owner of the national grid company (“Gridco”) incorporating a market operator while the Department of Public Enterprises can remain as the shareholder of the generation company (“Genco”). For an extensive expert report on the matter, see [http://rcci.co.za/wp-content/uploads/2016/11/Eskom-Asset-Restructuring-Tariff-path-project\\_Final\\_06052016.pdf](http://rcci.co.za/wp-content/uploads/2016/11/Eskom-Asset-Restructuring-Tariff-path-project_Final_06052016.pdf)
- In this manner Eskom’s present conflict of interest would be removed, Gridco to buy the most inexpensive power available on the market.
- Genco should exist only for the purpose of managing and sweating existing assets until end of life for the benefit of the country. It should get no return on the capital deployed, should not have any future vision of building additional power stations and should not pursue a distinct credit rating.

- 
- In order to remove the pressure on South Africa's sovereign balance sheet, Genco could open itself for private investment partners.
  - The remainder of the old Eskom (Gridco) should be right-sized for the task at hand and should continue to be funded from the electricity tariff.
  - Assuming Gridco is immediately implemented, electricity would immediately be available at a delivered price of below 65c/kwh.
  - The resultant Gridco must enable and facilitate a rational Integrated Resource Plan by buying the electricity that the plan requires from both public and private electricity generators.
  - The Eskom decommissioning schedule must be completely transparent and based on objective facts so that the National Grid Operator will know when the existing capacity will disappear (or not) and so that the required level of capacity can be maintained around it.
  - Investigation must be done into adding flexibility to the Eskom coal fleet (eg the ability to operate at intermediate outputs and/or to ramp up and down in response to demand) so that it can support the development of a renewable energy dominated electricity system.
  - The Eskom new-build at Medupi and Kusile should be postponed indefinitely after the completion of the units being commissioned now.
  - Electricity price increases could then be contained by allowing low-cost alternatives to Eskom to gradually penetrate the generation mix to a much greater extent.

- Eskom's amortised plant would still have an important role to play in providing the national economy with low-cost electricity until such time as these plants are decommissioned.
- Eskom's sunk costs on plant not yet amortised could then be amortised over an appropriate period of time and financed in a manner that ensures that electricity prices stay stable and the competitiveness of the national economy is maintained.
- An assessment needs to be done to ascertain whether Gridco as a distinct entity from the existing Eskom would have the required skill, ambition, money and know-how to expand and modernise the grid as required by the future energy mix of the country. If not, competition should be considered in that market and/or the entity might be replaced by an international operator that is up to the task.

1.7 NERSA's mandate and how to achieve the only route that leaves South Africa sustainable  
As appears from section 2 below, a proper legal interpretation of NERSA's mandate can avoid the situation where NERSA is forced to carry out its mandate in a manner that both Eskom and National Treasury agree will be very harmful to the South African economy.

## **2 Part 2: Eskom is not an efficient operator and hence is not legally entitled to additional cost recovery**

Eskom has been publicly refusing to sign further Power Purchase Agreements with preferred bidders under the REIPPP programme and is opposing an application at NERSA lodged in October 2016 by the South African Wind Energy Association aimed at declaring that Eskom has no discretion but has to sign in terms of its legal mandate. The Minister of Energy has now intimated that certain of these projects will be signed subject to a newly imposed price cap and further that it is appreciated that these projects will generally not come online before 2020/21.

It is true that the great majority of projects even if signed immediately cannot reach commercial operation in the 2018/2019 financial year.

## 2.1 Background to NERSA's mandate

NERSA's mandate was set out in great detail by the Supreme Court of Appeal in the Borbet case (case number 1288/2016 and 1309/2016). The essential parts are quoted herein. The footnotes have in places been incorporated in the text.

- NERSA was established in terms of the National Energy Regulator Act 40 of 2004 (NERA),<sup>1</sup> which, inter alia, regulates the generation, transmission, and distribution of electricity. Section 4 of NERA sets out NERSA's functions and provides, amongst others, that NERSA is to undertake the functions set out in section 4 of the Electricity Regulation Act 4 of 2006 (ERA). In section 2 of ERA the powers and duties of the regulator are set out as follows:

"The Regulator –

(a) must –

- (i) consider applications for licenses and may issue licenses for –
  - (aa) the operation of generation, transmission or distribution facilities;
  - (bb) the import and export of electricity;
  - (cc) trading;
- (ii) *regulate prices and tariffs;*

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<sup>1</sup> Section 3 of the Act provides: 'The National Energy Regulator is hereby established as a juristic person.'

- (iii) register persons who are required to register with the Regulator where they are not required to hold a license;
  - (iv) issue rules designed to implement the national government's electricity policy framework, the integrated resource plan and this Act;
  - (v) establish and manage monitoring and information systems and a national information system, and co-ordinate the integration thereof with other relevant information systems;
  - (vi) enforce performance and compliance, and take appropriate steps in the case of non-performance;
- (b) may –
  - (i) mediate disputes between generators, transmitters, distributors, customers or end users;
  - (ii) undertake investigations and inquiries into the activities of licensees;
  - (iii) perform any other act incidental to its functions.” (Emphasis added.)
- The objects of ERA are as follows:<sup>6</sup>
  - (a) [to] achieve the efficient, effective, sustainable and orderly development and operation of electricity supply infrastructure in South Africa;
  - (b) 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;

- 
- (c) facilitate investment in the electricity supply industry;
  - (d) facilitate universal access to electricity;
  - (e) promote the use of diverse energy sources and energy efficiency;
  - (f) promote competitiveness and customer and end-user choice; and
  - (g) facilitate a fair balance between the interests of customers and end users, licensees, investors in the electricity supply industry and the public.”
- Section 14(1) of ERA under the title “Conditions of license” provides, inter alia:
    - (1) The Regulator may make any license subject to conditions relating to –
      - (d) the setting and approval of prices, charges, rates and tariffs charged by licensees;
      - (e) the *methodology* to be used in the determination of rates and tariffs which must be imposed by licensees;
  - Section 15 of ERA sets out “Tariff principles”:
    - (1) A license condition determined under section 14 relating to the setting or approval of prices, charges and tariffs and the regulation of revenues –
      - (a) *must enable an efficient licensee to recover the full cost of its licensed activities, including a reasonable margin or return;*
      - (b) must provide for or prescribe incentives for continued improvement of the technical and economic efficiency with which services are to be provided;
      - (c) must give end users proper information regarding the costs that their consumption imposes on the licensee’s business;
      - (d) must avoid undue discrimination between customer categories; and

- 
- (e) may permit the cross-subsidy of tariffs to certain classes of customers.
- (2) A licensee may not charge a customer any other tariff and make use of provisions in agreements other than that determined or approved by the Regulator as part of its licensing conditions.
- (3) Notwithstanding subsection (2), the Regulator may, in prescribed circumstances, approve a deviation from the set or approved tariffs.”
- Section 21(2) of ERA provides:  
“A licensee may not discriminate between customers or classes of customers regarding access, tariffs, prices and conditions of service, except for objectively justifiable and identifiable differences approved by the Regulator.”
  - Municipalities are charged with the obligation to ensure electricity reticulation services within their areas of jurisdiction. Section 27 of ERA states that each municipality must exercise its executive authority and perform its duty by:
    - (a) complying with all the technical and operational requirements for electricity networks determined by the Regulator;
    - (b) integrating its reticulation services with its integrated development plans;
    - (c) preparing, implementing and requiring relevant plans and budgets;
    - (d) progressively ensuring access to at least basic reticulation services through appropriate investments in its electricity infrastructure;
    - (e) providing basic reticulation services free of charge or at a minimum cost to certain classes of end users within its available resources;

- (f) ensuring sustainable reticulation services through effective and efficient management and adherence to the national norms and standards contemplated in section 35;
  - (g) regularly reporting and providing information to the Department of Provincial and Local Government, the National Treasury, the Regulator and customers;
  - (h) executing its reticulation function in accordance with relevant national energy policies; and
  - (i) keeping separate financial statements, including a balance sheet of the reticulation business.”
- The Eskom license “sets out Eskom’s duties, largely in line with the provisions of ERA. Under ‘Specific Conditions’, Eskom is required to maintain financial records in relation to the distribution of electricity. Clause 4.6 of the license provides that ‘the licensee’ shall comply with ‘the price and tariff methodology’ provided by NERSA in determining its prices and tariffs and it is restricted to charging the consumer and/or end-user tariffs and prices approved by NERSA. Under ‘General Conditions’, Eskom is required to comply with the applicable provisions of ERA. It is also required to take reasonably practicable steps to protect the environment and to ensure safety in the course of operations associated with the license, including, but not only those specified, in health and safety and environmental legislation. In terms of s17 of ERA, NERSA may revoke a license on the application of a licensee if the licensed facility or activity is no longer required and the licensed facility or activity is not economically viable. That provision is mirrored in clause 7 of Eskom’s license. Section 18 of ERA deals with contraventions of a license and allows for the Regulator to sit as a tribunal to deal with allegations of a failure to comply with a license condition, or with any provision of ERA. Section 18(5) of ERA allows for financial penalties to be imposed on licensees, depending on the degree of non-compliance. Section 19 of ERA empowers the Regulator to apply to the high court for an order suspending or revoking a license, if there are grounds for doing so. Many of the

sections of ERA referred to and the license conditions predominantly set and define the parameters of the relationship between NERSA and licensees.”

The Honourable Supreme Court of Appeal continued to analyse the MYPD methodology in the following terms:

- The Multi-Year Price Determination Methodology (the MYPDM)

“It is common cause that tariffs to be charged by licensees are determined by NERSA at intervals in accordance with the MYPDM, ostensibly in terms of s 14(1)(e) of ERA. This is envisaged in the Electricity Pricing Policy, GN 1398, GG 31741,19 December 2008.

Each price determination interval covers a period of three to five years, hence the description ‘multi-year price determination methodology’. The MYPDM is apparently updated in relation to each interval... It is the interpretation and application of the MYPDM3 that lies at the heart of this appeal.”

- In keeping with the principle of transparent and accountable governance and administration, the MYPDM3 is contained in a comprehensive document and was the product of extensive consultation by NERSA with interested and affected parties. The introduction to the document is significant and I consider it necessary to set it out in full:

‘The Multi-Year Price Determination (MYPD) Methodology is developed for the regulation of Eskom’s required revenues. It forms the basis on which the National Energy Regulator of South Africa (NERSA or “the Energy Regulator”) will evaluate the price adjustment applications received from Eskom. The MYPD was first introduced in 2006 for implementation from 01 April 2006 to 31 March 2009. It is a cost-of-service-based methodology with incentives for cost savings and

efficient and prudent procurement by the licensee (Eskom). The Methodology also provides for Services Quality Incentives (SQI) for Eskom. On an annual basis, the MYPD runs concurrently with Eskom's financial year(s). A second MYPD period started from 01 April 2010 to 31 March 2013, with the next one scheduled to run from 01 April 2013 to 31 March 2018.

"In developing the MYPD Methodology, the following objectives were adopted:

1. to ensure Eskom's sustainability as a business and limit the risk of excess or inadequate returns; while providing incentives for new investment;
2. to ensure reasonable tariff stability and smoothed changes over time consistent with socio-economic objectives of the Government;
3. to appropriately allocate commercial risk between Eskom and its customers;
4. to provide efficiency incentives without leading to unintended consequences of regulation on performance;
5. to provide a systematic basis for revenue/tariff setting; and
6. to ensure consistency between price control periods.

*The development of the Methodology does not preclude the Energy Regulator from applying reasonable judgment on Eskom's revenue after due consideration of what may be in the best interest of the overall South African economy and the public.*  
(Emphasis added.)

The qualification in the last part of the introduction is significant. It allows NERSA latitude to exercise "reasonable judgment" after due consideration of what may be in the public interest.

- The MYPDM3 reflects, in large part, government's electricity pricing policy, issued by the Department of Minerals and Energy. The MYPDM3 and the pricing policy are in line with the tariff principles set out in s15 of ERA. It provides for

the recovery of the full costs of licensed activities, including a reasonable margin or return and provides for prescribed incentives for continued improvement of technical and economic efficiency. Section 3 of the MYPDM3 sets out a formula to determine the allowable revenue for Eskom within the interval, which includes taking into account, inter alia, its asset base, weighted average cost of capital, expenses and other factors which for present purposes are not material.

## 2.2 Case law on the interpretation of "**efficient operator**":

We saw above that Section 15 of ERA sets out 'Tariff principles':

- (1) A license condition determined under section 14 relating to the setting or approval of prices, charges, and tariffs and the regulation of revenues –

((a)...(d))

(f) must enable an efficient licensee to recover the full cost of its licensed activities, including a reasonable margin or return;

Attention will now turn to what the underlined phrase means.

The Supreme Court of Appeal has pronounced on the principle of interpretation at least four times this century, maintaining a very steady line of reasoning about how words should be interpreted:

- In *CSARS v Airworld CC and Another*,<sup>2</sup> Hurt AJA stated that:

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<sup>2</sup> [2008] 2 All SA 593 (SCA).

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“The first part of the interpretation must be to consider the words of subsection (1) to decide whether their meaning is clear. ... the question is whether the word, properly considered in its context, is nevertheless ambiguous. Most of the rules of interpretation have been devised for the purpose of resolving apparent ambiguity and arriving at an interpretation which accords as well as possible both with the language which the Legislature has used and with the apparent intention with which the Legislature has enacted the relevant provision. The interpreter must endeavour to arrive at an interpretation which gives effect to such purpose. The purpose (which is usually clear or easily discernible) is used, in conjunction with the appropriate meaning of the language of the provision, as a guide in order to ascertain the legislator’s intention”

(Emphasis added)

- In *Standard General Insurance Co Ltd v Commissioner for Customs and Excise*,<sup>3</sup> Nugent and Lewis JJA said:

“Rather than attempting to draw inferences as to the drafter’s intention from an uncertain premise we have found greater assistance in reaching our conclusion from considering the extent to which the meaning that is given to the words achieves or defeats the apparent scope of the purpose of the legislation... the word must ‘take its colour, like a chameleon, from its setting and surrounds in the Act.’”

(Emphasis added)

- In *Natal Joint Municipal Pension Fund v Endumeni Municipality*,<sup>4</sup> Wallis JA stated that:

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<sup>3</sup> [2004] 2 All SA 376 (SCA) (31 March 2004).

<sup>4</sup> 2012 (4) SA 593 (SCA) at para 18.

“Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusiness like results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used.”

- In *CSARS v Bosch*,<sup>5</sup> Wallis JA referred to his decision in the *Natal Joint Municipal Pension Fund case* and reiterated that the interpretation of legislation starts with the words of the section considered in the light of their context, the apparent purpose of the provision and any relevant background material.

(Emphasis added)

- In *Chetty t/a Nationwide Electrical v Hart NO and another*,<sup>6</sup> the court stated that “... the method of attributing meaning to the words used in legislation involves, as a point of departure, examining the language of the provision at issue, the language and design of the statute as a whole and its statutory purpose. So when the lawmaker uses particular words to achieve its purpose they must be given effect. In so doing a court will apply ordinary rules of grammar and syntax. It is not permissible to ignore or distort the meaning of the words to achieve its purpose. For in so doing a court will be substituting its own words for

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<sup>5</sup> (394/2013) [2014] ZASCA 171 (19 November 2014) at para 9.

<sup>6</sup> 2015 (6) 424 (SCA).

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those of Parliament. But if the words used are reasonably capable of bearing more than one meaning, the consequences of the divergent interpretations must be examined so that a meaning that is likely to further rather than hinder its purpose is adopted. In this regard a meaning that is more sensible and business like is to be preferred over one that has a contrary effect.”

In this case NERSA is required to ascertain what “*an efficient operator*” means. It is submitted that there is zero ambiguity in the phrase: it means, very clearly, *an operator that is efficient*. Thus, if Eskom is an efficient operator, it can recover its full costs plus a return, if not, it cannot.

NERSA has traditionally interpreted this phrase to mean something like “*An operator may recover its full costs and a return for those activities for which it can be shown to have been efficient*”. The negative of this statement has always been implied to be “*and cannot recover its costs nor a return on funds spent on activities/expenditures for which it cannot be shown to have been efficient*”.

The all or nothing outcome that emerges from a proper interpretation of the Electricity Regulation Act, upon a fresh consideration untainted by what happened in the past, actually yields a logical result.

The Acts aims, amongst other aspects:

- a. [to] achieve the efficient, effective, sustainable and orderly development and operation of electricity supply infrastructure in South Africa;
- b. 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;
- f. promote competitiveness and customer and end user choice; and

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

Eskom is a regulated monopoly with much power over the majority of South Africans, owned by the South African government. Remembering that Eskom's revenue can only come from two sources (the electricity consumer or the taxpayer via the fiscus), a primary intention of the Act is to protect consumers by ensuring reasonable prices. These consumers do not have the usual consumer choice. If they are not receiving an efficient service from an efficient operator, they should not be held at virtual gunpoint to purchasing electricity at extortionate prices. In such a case, Eskom, as owned by the government, becomes the government's problem, and the government has to keep it running from government funds (the fiscus), until such time as Eskom returns to being an efficient operator.

Note again the cautionary words above of the Supreme Court of Appeal in the Natal Joint Municipal Pension Fund where Wallace, JA said: "*Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used.*"

It needs to be stressed that NERSA would maintain an "auditing" function even upon a correct interpretation of the Act. Even when Eskom is an "efficient operator", it is NERSA's task to determine the true extent of Eskom's likely expenditure.

### 2.3 Correct interpretation of NERSA's mandate

The words actually used are "*An efficient operator*". In that context the first question to be asked before Eskom's revenue application is entertained in its detail, is whether Eskom is "an efficient operator. If not, its revenue application is to be rejected in its totality.

## 2.4 Is Eskom an efficient operator?

Eskom's qualified audit and the fact that least R3 billion was spent in the last financial year on irregular expenditure (effectively fraud and theft) should in and of itself answer this question in the resounding negative.

The Denton's Report and State Capture Report are incorporated herein by way of reference. Details of the former are at

[https://www.scribd.com/document/339464501/Dentons-report-the-investigation-into-Eskom#from\\_embed](https://www.scribd.com/document/339464501/Dentons-report-the-investigation-into-Eskom#from_embed)) while the latter can be found at

[http://www.pprotect.org/library/investigation\\_report/investigation\\_report.asp](http://www.pprotect.org/library/investigation_report/investigation_report.asp) and at <http://www.da.org.za/wp-content/uploads/2016/11/State-of-Capture-14-October-2016.pdf>

During the last months, further reports emerged, for instance that Koko Matshela, the Interim CEO of Eskom, had in his previous position awarded contracts to the value of R1 billion to his stepdaughter, as appears from the newspaper report at

<http://www.fin24.com/Economy/Eskom/matshela-kokos-stepdaughter-nets-r1bn-in-eskom-contracts-20170326>

As additional evidence the following can be shown:

| Salient metrics: ten years | 2007    | 2017    | Change (%) |
|----------------------------|---------|---------|------------|
| Total sales (GWh)          | 218,120 | 214,121 | -2%        |
| Nominal capacity (MW)      | 42,618  | 44,134  | 4%         |
| Revenue (R'bn)             | 40      | 177     | 343%       |
| Net debt (R'bn)            | 30      | 334     | 1013%      |
| Total assets (R'bn)        | 143.70  | 710     | 394%       |
| Net finance cost (R'bn)    | 1.70    | 14.33   | 743%       |
| Profit for the year (R'bn) | 4.60    | 0.88    | -81%       |
| Employees                  | 32,674  | 47,658  | 46%        |

Source: Moneyweb

On the new build, Eskom's abysmal record looks like this:

- a. Earlier budgets were R69 billion for Medupi ([https://en.wikipedia.org/wiki/Medupi\\_Power\\_Station](https://en.wikipedia.org/wiki/Medupi_Power_Station)) and R80 billion for Kusile (see <http://www.dailymaverick.co.za/article/2016-07-07-medupi-kusile-and-the-massive-costtime-overrun/#.V8cZfeQkpxI>).
- b. The projected total capital expenditure on these plants has now been estimated by observers as going as high R193 billion for Medupi and R213 billion for Kusile. More detail is available at <http://www.ee.co.za/article/understanding-cost-electricity-medupi-kusile-ippets.html>. Even Eskom's own actual spending to date and projections for completion are way over the original estimates and are not final: Eskom's Integrated Report 2017 says R101.3 billion has been spent on Medupi to date and its revised budget is R145 billion, while R112.4 billion has been spent on

Kusile to date and its revised budget is R161.4 billion. Eskom has not provided clear budgets or delivery dates for these, which adds to the costs.

- c. What has been achieved in more than a decade is the commissioning of only three of twelve units. It appears the last units are still at least five years away from completion.
- d. The Ingula pumped hydro scheme increased in price from about R9 billion to an alleged R36 billion (see <http://www.fin24.com/Economy/Eskom/eskom-under-fire-as-ingula-costs-said-to-balloon-to-r36bn-20160822>). Eskom's own tally (in the Integrated Report 2017) of the spending now that Ingula is completed is R29.3 billion.
- e. As appears below, Eskom's new build since 2006, on average, has cost more than three times what it was budgeted to cost and took more than twice the time that was budgeted at the outset.

| Plant   | Initial capex ZAR billion | Estimated final capex ZAR billion | Cost over run | Initial commissioning date – commenced 2008 | Estimated final commissioning date | Time over run |
|---------|---------------------------|-----------------------------------|---------------|---|------------------------------------|---------------|
| Medupi  | 69                        | 193                               | 180%          | 2012 (6 years)                              | 2021 (13 years)                    | 116%          |
| Kusile  | 80                        | 213                               | 166%          | 2012 (6 years)                              | 2023 (15 years)                    | 150%          |
| Ingula  | 9                         | 36                                | 300%          | 2012 (4 years)                              | 2016 (8 years)                     | 100%          |
| Average |                           |                                   | 215%          |   |                                    | 122%          |

With Eskom's now-suspended CFO Anoj Singh stating that Eskom's debt will peak about R200 billion above the present level (and assuming debt will not be incurred to pay operational expenses) one can only assume that Eskom is expecting the aggregate cost for Medupi and Kusile completion to rise by another R200 billion, which would bring

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Medupi's ultimate cost to near R300 billion (against the early budget of R69 billion). See <http://ewn.co.za/2017/07/06/eskom-signs-r19-6bn-loan-agreement-with-china>.

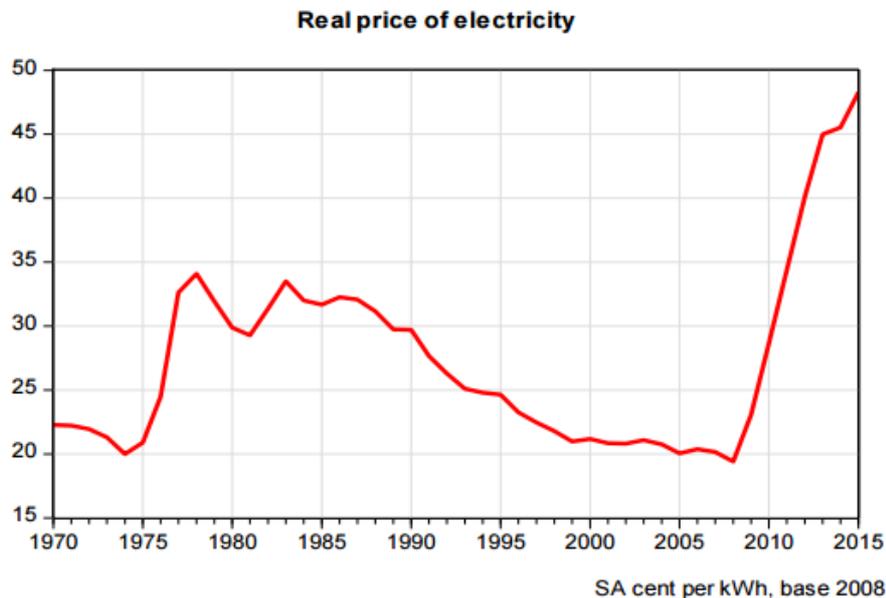
When construction started on Medupi in 2006, the completion date was six years and R69 billion away. Now after 11 years, appears to be four years and R100 billion rand away.

The pattern for Kusile is the same.

Indeed, a rational person may ask whether, in 2021, completion would still be multiple years and perhaps a hundred billion rand away and would perpetually remain so, no matter how much is spent.

With both power plants now financially further from completion than they were at the outset and with Eskom saying that it is in a situation of over-supply of energy (see below), very serious questions will have to be asked about whether construction on the later units should not be immediately suspended in the public interest.

A look at the astounding electricity price increases excluding inflation reflects the sad fact that the consumer has been asked to pay for these exorbitant expenses through the tariff:



See: <http://businesstech.co.za/news/energy/91216/eskoms-shocking-annual-price-hike-since-2007>

The upper end of this tariff graph, if Eskom is allowed to continue, will have to be extended again to the top by about double in the next five years.

It is reasonable to attribute much of these unexplained capital expenditure overruns to corruption and state capture, particularly in the light of ongoing revelations on Eskom corruption.

Indeed, the following visual depiction shows just how central Eskom is to state capture:



In such an eventuality, Parliament will then have the option to reassess the electricity sector through an amendment of the regulatory framework. It is hoped that Parliament would choose to unbundle Eskom as suggested above. It could however also choose to maintain the status quo as it was previously understood – by amending the ERA to give NERSA the authority to look at the efficiency of Eskom’s expenses as opposed to the efficiency of Eskom as an operator, should Parliament consider this a wiser course of action.

## 2.6 Alternative interpretation of NERSA’s mandate (Medupi, Kusile)

Should NERSA not accept OUTA’s submission on the proper interpretation of the “Efficient operator” phrase, OUTA will reserve its rights to request a judicial review of the ultimate NERSA decision, together with possible interim relief.

In such a case, NERSA is likely to reach its final decision on the Eskom revenue application in the traditional manner, by looking at whether expenses were prudently incurred.

OUTA would like to point out that in such a case, NERSA would be forced to assess Eskom’s efficiency in building Medupi and Kusile respectively and would, on a consideration of the astounding cost and time over-runs, have to deny Eskom any recoupment of these expenses, which run to R46.5 billion for the next financial year (see Eskom’s Revenue Application page 63).

Not only would this then amount to asking the taxpayer to subsidise the electricity price, but it would likely have severely negative impacts on South Africa’s sovereign credit rating – as pointed out by National Treasury in its response to the Revenue Application.

Indeed, it is submitted that such a course of action by NERSA would be flawed in law but would lead to exactly the same outcome as giving Eskom no increase whatsoever.

### 3 Part 3: Eskom is attempting to defraud NERSA, taxpayers and electricity customers in its revenue application

#### 3.1 Definition of fraud and elements of the crime

Fraud is defined in South African law as:

*"unlawfully making, with intent to defraud, a misrepresentation which causes actual prejudice or which is potentially prejudicial to another".*

*The elements of fraud that must be proved by the State are*

- *a misrepresentation;*
- *unlawfulness;*
- *the intent to defraud and prejudice;*
- *actual or potential prejudice*

#### 3.2 Count 1: Eskom claiming more than R6 billion for expenses it knows cannot be incurred in the 2018/2019 financial year:

In short: Eskom is claiming more than R7.4 billion for the Independent Power Producer (IPP) rounds 3.5 – 4.5. This is fraudulent in that firstly they are refusing to sign, therefore none or only a few projects will come and, secondly, even if all are signed, almost none will be commissioned in time to impact this revenue application time period. Eskom knows all this – refer to revenue application to show everything. Many businesses and individuals will be prejudiced by higher electricity tariffs than would otherwise be the case

| Element of fraud                      | Eskom fulfilling element of crime   | Evidence   |
|---------------------------------------|---|--|
| <i>a</i><br><i>misrepresentation;</i> | Eskom represents that it will incur about R7.4bn in costs on REIPPPP Round 3.5 – 4.5 – see table 24 page 68 | Eskom denies in front of NERSA in the SAWEA complaint process that it is legally obliged to sign these agreements and has been actively refusing to do so. If the recent plan to sign up to 77c/kWh is carried out, the great majority of projects will not be signed. In any event, it is |

| Element of fraud                            | Eskom fulfilling element of crime   | Evidence  |
|---|---|---|
|   |   | highly unlikely any of the projects will be complete in the 2018/2019 financial year and Eskom knows this from earlier bid rounds.  |
| <i>unlawfulness;</i>                        | Misrepresentation to NERSA and SA public is unlawful  | Speaks for itself.  |
| <i>the intent to defraud and prejudice;</i> | Eskom's intent is clearly to increase its revenue beyond what it should be entitled to, to the prejudice of the consumers and taxpayers.  | Speaks for itself: claims the refund in one NERSA proceeding while denying in another NERSA proceeding that it is obliged to incur the expense and while stating it is refusing to do so.   |
| <i>actual or potential prejudice</i>        | There will be actual prejudice.   | By Eskom's own admission, <b>up to 137,000 people a year will lose employment opportunities</b> . Many business owners will have to close and will lose their source of revenue.  |
| <i>"Attempted" fraud</i>                    | Eskom has made misrepresentations in its revenue application. This response and others like it may cause the prejudice not to manifest. It is clear however that the attempt is complete. | The commissioning time for a solar PV plant and wind farm is around 12 to 18 months. Eskom knows this from earlier bidding rounds. The Redstone project in Round 3.5 would take far longer. Thus, signatures at the end of October would see only some of the projects come online only for the last 3 to 4 months of the FY 2018/2019, at the very earliest. Indeed, the Minister of Energy made exactly this point in the media when stating why these projects will not threaten Eskom's alleged over-supply that is likely to persist until 2020-2021. If she knows it after having engaged Eskom, then Eskom knows it too. |

**ORGANISATION UNDOING TAX ABUSE (OUTA)**

Co Reg: 2012/064213/08 NPO #: 124381NPO  
**DIRECTORS:** Wayne L Duvenage (Chairman), Leopold J J Pauwen,  
**NON-EXECUTIVE DIRECTORS:** Phumlani M Majazi, Ms Ferrial Adam

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### 3.3 Count 2: Eskom claiming over R25 billion for generation projects that do not exist:

Eskom is claiming R45 billion for generation new build in 2018/19 saying Medupi and Kusile makes up about R20 billion (see revenue application page 63, second last bullet). There are no other projects on the go by Eskom's own admission. This is fraud, either by lying about what is spent on Medupi and Kusile or by trying to create a slush fund. Many businesses and individuals will be prejudiced by higher electricity tariffs than would otherwise be the case.

| <b>Element of fraud</b>                     | <b>Eskom fulfilling element of crime</b>   | <b>Evidence</b>   |
|---|--|---|
| <i>a<br/>misrepresentation;</i>             | Misrepresents that Medupi and Kusile will make up "only" about R20 billion of the generation new build expense of R44.685 billion. | No other new-build projects are on the go except Medupi and Kusile, according to the revenue application (page 51). It mentions Ingula being complete by beginning FY2018 (page 52). It is in fact completed and fully commercially operational. Insurance claims have already paid out for Duvha and likely Majuba (page 89 top). Transmission and distribution expenses are on a separate budget line, as is future fuel. |
| <i>unlawfulness;</i>                        | Misrepresentation to NERSA and SA public is unlawful.  | Speaks for itself.  |
| <i>the intent to defraud and prejudice;</i> | Eskom's intent is clearly to increase its revenue beyond what it should be entitled to, to the prejudice of the SA consumers.      | Speaks for itself: claims the refund in one NERSA proceedings while denying in another NERSA proceedings that it is obliged to incur the expense and while stating it is refusing to do so.   |

| Element of fraud                     | Eskom fulfilling element of crime   | Evidence  |
|--------------------------------------|---|---|
| <i>actual or potential prejudice</i> | There will be actual prejudice to taxpayers and consumers, likely paying a portion of the tariff for an expense that does not exist.  | Should Eskom allow a more than R25 billion capital expense that is not tied to any on-going project, Eskom would be creating a giant slush fund from which to continue corruption. Should the truth be that the entire amount is needed for Medupi and Kusile, Eskom if unchallenged would be able to hide its own efficiency in the new-build by understating the annual cost by more than half. |
| <i>Attempted fraud</i>               | Eskom has made misrepresentations in its revenue application. This response and others like it may cause the prejudice not to manifest. It is clear however that the attempt is complete. |   |

3.3 Count 3: Eskom is hiding its own expert reports on demand destruction to convince NERSA to grant an increase even though Eskom insolvency is assured:

Eskom claims early on in the document not have done any elasticity of demand studies, which gets it off the hook about owning up about the utility death spiral. However, later in the document when National Treasury said it did a study that showed certain outputs, Eskom does an about face and says it commissioned **two** studies that agree with Treasury's views on demand destruction. Thus Eskom hides its knowledge about the fact that it will not be sustainable despite price increases. Many businesses and individuals will be prejudiced by higher electricity tariffs than would otherwise be the case.

| Element of fraud                   | Eskom fulfilling element of crime  | Evidence   |
|------------------------------------|--|--|
| <p><i>a misrepresentation;</i></p> | <p>Eskom implies early on in its revenue application that it doesn't know what the impact of its price increases would be on the demand and thus the sustainability of the system – if demand collapses, prices have to go up again to carry the fixed costs over a smaller base of consumers. It states that is has not invested in research and thus doesn't know what elasticity would do but is bold enough to doubt a direct correlation between a higher price and lower sales.</p> <p>The truth that emerges later in the document is that Eskom has indeed commissioned two studies that confirm such a correlation.</p> | <p>Revenue application page 41: "In order to have a measure of price elasticity with an exact impact on sales volumes, there is need to isolate the impact of tariff increases, weakening global economic growth, collapse of commodity prices, seasonal changes (temperature and rainfall variations) and weak demand for commodities. <i>The quantum of change in the sales volumes does not demonstrate a direct correlation to the change in average price.</i></p> <p><i>Given the foregoing context, measuring price elasticity would require investment in research</i></p> <p>to arrive at a quantifiable measure of the price elasticity.</p> <p><i>The mitigation strategies employed by households and firms described above will have an adverse impact on electricity sales for Eskom and municipalities. Looking at households specifically, under relatively conservative assumptions and a moderate tariff path (of a ten per cent per annum increase over the next 5 years), about twenty six per cent of total</i></p> <p>Treasury remarks on page 129 – 130: "about twenty six per cent of total residential electricity sales could go off-grid by 2030. From an analysis of listed companies, National Treasury estimates show that the equivalent of</p> |

| Element of fraud | Eskom fulfilling element of crime | Evidence   |
|------------------|-----------------------------------|--|
|                  |                                   | <p><i>up to thirty-four per cent of mining, eight per cent of industrial (from a sample size of 21 companies) and one per cent of commercial electricity generation sales currently supplied by Eskom has the potential to go off-grid, by 2040. Furthermore, a sharp hike in electricity tariffs will increase the prevalence of non-technical load losses, as certain households can no longer afford the higher tariffs yet still continue to use electricity. In response to these shocking impacts, Eskom says: "<u>Eskom notes the analysis by National Treasury. Eskom has also commissioned two economic impact studies that have been finalised subsequent to the submission of the draft revenue application to SALGA and National Treasury. The analysis has yielded similar results to that reflected in National Treasury's study. The details of the studies will be included in the final submission to be made to NERSA.</u></i></p> <p><i>Eskom has thus known at the time of submitting the revenue application that its price increase application will collapse demand and likely make Eskom unsustainable as a business enterprise, yet chosen to deliberately keep this information to itself and intimate that it does not know what the impact will be</i></p> |

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| <b>Element of fraud</b>                     | <b>Eskom fulfilling element of crime</b>  | <b>Evidence</b>  |
|---|---|--|
| <i>unlawfulness;</i>                        | Misrepresentation to NERSA and SA public is unlawful.   | Speaks for itself.   |
| <i>the intent to defraud and prejudice;</i> | Eskom's intent is clearly to convince NERSA that a revenue increase will make it (Eskom) sustainable for the long term while it knows this probably to be untrue.                         | Speaks for itself – claims the refund in one NERSA proceedings while denying in another NERSA proceedings that it is obliged to incur the expense and while stating it is refusing to do so. |
| <i>actual or potential prejudice</i>        | The entire South African economy stands to be severely prejudiced, including rate payers and taxpayers.   | A truthful look at Eskom's sustainability would lead to the conclusions in this document: it cannot be sustained and should be restructured as soon as possible.                             |
| Attempted fraud                             | Eskom has tried to hide the truth in its revenue application. This response and others like it may cause the prejudice not to manifest. It is clear however that the attempt is complete. |  |

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## 4 Part 4: Transparency is not negotiable

There are two key problems with transparency in this pricing application. The first is Eskom's attempt to hide the costs of corruption and the second is NERSA's failure to require Eskom to make key information public. These two matters are related, as we believe the hidden information will help shed light on corruption.

4.1 The revenue application is defective as it still does NOT provide adequate transparency, relies on what are now clearly corrupted forecasts, and does not identify how much fraud and corruption has been financed by the electricity consumer since 2005/7 when accelerated corruption commenced. By endorsing this application, NERSA will be granting the Eskom corruptors a 20% increase in revenue that can be stolen.

4.2 On 27 July 2017, NERSA disallowed Eskom's application for less transparency through the exclusion of vital information and published this decision. However when Eskom's revenue application was published, crucial information required in the revenue application was redacted from the published application. OUTA asked NERSA to provide this missing information – which was clearly stated in the NERSA decision of 27 July as required – but NERSA refused this, indicating that another decision had been taken at a meeting on 4 September which allowed Eskom to block out the coal costs in the interests of "commercial or financial interests". NERSA has confirmed to OUTA that this issue was not included in the published agenda for that NERSA meeting. OUTA asked for the minutes of this meeting but NERSA indicated that these were not available. OUTA has asked NERSA for a copy of Eskom's request for this secrecy and a copy of NERSA's decision in this regard but, by the time this submission was filed, that information had not been supplied. In the light of this, OUTA can come to no other conclusion than that NERSA is not fulfilling its mandate to the people and by default, is acting in collusion with Eskom to hide key information and possible evidence of corruption.

### 1.3 COMMENTS ON ADMINISTRATIVE ACTION

It should be noted that NERSA's decision to entertain Eskom's revenue application (and ultimately grant approval), constitutes administrative action as contemplated in the Promotion of Administrative Justice Act, 2000 ("PAJA"). As such, NERSA's conduct (decisions) is subject to, *inter alia*, the principle of transparency.

OUTA contends that NERSA falls abysmally short of its obligation to adhere to the principles set out in PAJA. Considering the recent judgment in the *Borbet*-case, decisions on revenue application by licensees "... is entirely within NERSA's compass". Such decisions are nevertheless subject to the principles set out in PAJA, which gives effect to section 33 of the Constitution.

NERSA should bear in mind that it will not place itself in a proper position to adjudicate Eskom's revenue application. An equilibrium needs to be drawn in considering a revenue application – firstly the interest of public as a whole, and secondly Eskom's financial sustainability.

As Eskom is withholding information relevant to its revenue application, NERSA cannot properly decide whether or not to grant Eskom's proposed increase. In order to determine what would be in Eskom's best interest (for its financial sustainability), NERSA ought to be in a position to determine Eskom's current financial position. The omission of crucial information makes such determination almost impossible. NERSA decision cannot be made in the absence of relevant considerations, such as the information omitted.

OUTA reserves its rights to approach the court for judicial review of NERSA's decision, should it not apply its mind and its decision fall short of the principles enshrined in PAJA.

## 5 Part 5: The results of NERSA condonation of price increases over the years.

The lavish and excessive previous price increases approved by NERSA allowed Eskom to lavish & excessive past increases afforded by NERSA allowed Eskom to:

- 5.1 Increase staff headcount by 50% without any increase in sales (Eskom AR 2017).
- 5.2 Fund a more than R27bn budget overrun on Ingula pumped storage power station.  
(<http://www.fin24.com/Economy/Eskom/after-spiralling-costs-ingula-is-now-powering-the-economy-20170309-2>)

- 5.3 Fund a more than R65bn overrun on Medupi.  
(<https://www.dailymaverick.co.za/article/2016-07-07-medupi-kusile-and-the-massive-costtime-overrun/#.Wd0UIXlx2Uk>)
- 5.4 Fund a more than R50bn overrun on Kusile.  
(<https://www.dailymaverick.co.za/article/2016-07-07-medupi-kusile-and-the-massive-costtime-overrun/#.Wd0UIXlx2Uk> )
- 5.5 Increase the cost of coal from Gupta mines by more than R300 per ton.
- 5.6 Blow more than R1.6bn on McKinsey/Trillian with no value delivered.  
(<https://www.ft.com/content/fa912466-ada7-11e7-aab9-abaa44b1e130>)
- 5.7 Keep McKinsey/Accenture others on hand on the excuse of turnaround plans or cost cutting since 2005, yet results year after year are more pathetic than ever.  
(<http://www.engineeringnews.co.za/print-version/efficient-capital-build-services-costs-and-data-analytics-key-to-electricity-operations-consultancy-2015-05-15> )
- 5.8 Allowed the Eskom Board to propose and/or condone bonus payouts to former CE Brian Dames R22 million and for former CE Brian Molefe of R30 million when the performance of Eskom has deteriorated.  
(<http://www.fin24.com/Economy/Eskom/brian-molefe-the-biggest-winner-of-eskoms-bonus-bill-20170719> ) and (<http://ewn.co.za/2017/07/17/the-truth-of-brian-molefe-s-r30m-eskom-golden-handshake-exposed>)
- 5.9 Spend more than R10 billion on diesel because of fabricated blackouts.  
(<https://www.iol.co.za/news/south-africa/western-cape/who-will-pay-eskoms-r10bn-diesel-bill-1675362>)
- 5.10 Siphon off more than R1.4 trillion from the SA economy since 2005 to fund the capex that should have cost no more than R93 billion (Eskom AR 2005 pg 46 & 73).
- 5.11 Endorsed Eskom decline in efficiency in every sphere of activity.
- 5.12 Implement countless other corrupt and fraud issues that are expected to be uncovered by Parliament in the inquiry by the Portfolio Committee on Public Enterprises. (<http://allafrica.com/stories/201709280818.html>)

- 5.13 Spend hundreds of millions of rand on nuclear deals via “Zuma pals”, despite these not being justified and being very premature. (<https://mg.co.za/article/2016-09-16-00-zuma-pals-clinch-first-nuclear-deal>)
- 5.14 Paying the ANC SG family business more than R1.4 billion per year on a food contract at Medupi, ensuring that delays will continue for at least next five years. (<https://mybroadband.co.za/news/energy/116039-eskoms-r1-4-billion-lunch-bill.html>)
6. In addition, the whole pricing regime has been exacerbated by NERSA’s lack of capacity to regulate Eskom or itself being captured. Whilst in theory NERSA should be efficient and capable of monitoring Eskom’s efficiency or lack thereof, it is patently clear that NERSA either willfully or involuntarily failed to fulfill its regulatory role, resulting in billions of rand of corruption going unquestioned and with ongoing funding from electricity consumers.
7. Given the deficiencies in NERSA’s capacity to regulate, together with billions of rand of graft combined with defects in the regulatory regime and Eskom’s flawed or deliberate fraudulent forward projections of growth, it would be better to afford Eskom a zero percent increase and to have Eskom justify claims via the RCA process. (<http://www.miningmx.com/special-reports/mining-yearbook/mining-yearbook-2017/30368-power-drain-eskom-sliding-towards-bankruptcy/>) and (<http://www.fin24.com/Economy/Eskom/eskoms-20-uses-impossible-assumptions-20170609>) and (<http://www.sajs.co.za/forecasting-electricity-demand-south-africa-critique-eskom%E2%80%99s-projections/inglesi-roula-pouris-anastassios>) where the SA Journal of Science says:

Within a short period, Eskom has applied to the National Energy Regulator of South Africa (NERSA) for the third time since the 2008 electricity crisis, proposing a multiyear price determination for the periods 2010–2011 and 2012–2013. The new application, submitted at the end of September 2009, motivated for the debate of strategies with which the consequences of the proposed price hikes could be predicted, measured and controlled. In his presentation to Parliament in February 2009, Eskom’s then CEO, Mr Jacob Maroga presented the current energy situation in the country, the reasons for the crisis in 2007–2008, as well as the challenges

of the future. The purpose of this paper is to contribute some new ideas and perspectives to Eskom's existing arguments regarding the demand for electricity. The most important issue is the fact that Eskom does not sufficiently take into account the impact of the electricity prices in their electricity demand forecast. This study proposed that prices have a high impact on the demand for electricity (price elasticity of -0.5). ***Employing similar assumptions for the country's economic growth as Eskom, the results of the forecasting exercise indicated a substantial decrease in demand (scenario 1: -31% in 2025 and scenario 2:-18% in 2025). This study's findings contrasted significantly with Eskom's projection, which has extensive implications as far as policy is concerned.***

## CONCLUSION

South Africa's economy can no longer be captured by deliberate and fraudulent over-forecasts which guarantee Eskom massive price increase (its own projections run at 20% per year for five years) – which must then be funded by an embattled public with little recourse from an unsympathetic and seemingly biased NERSA, which appears to side with Eskom to hide from public scrutiny the corruption in the coal contracts, over and above other widespread corruption inside Eskom.

Based on the above, it is our contention that a zero % increase is justified under the current circumstances and that NERSA owes the public a full inquiry into lapses in the regulation of Eskom. We thus as NERSA to refuse any revenue or price increase to Eskom.

For many years now, both NERSA and the South African public have swallowed extreme excesses from Eskom in the implicit belief that we need Eskom and cannot allow it to implode – to the point of stretching the interpretation of its cost-recovery mechanism beyond the ordinary meaning of the words as contained in the Electricity Regulation Act.

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As South African citizens, we have a responsibility to future generations not to saddle the country with insurmountable debt. We have other options to the Eskom that presently exists – and an implosion of the present Eskom seems near-certain. For this reason the time has come to apply the law as it stands, properly interpreted, and to deny Eskom any price increase until it becomes an efficient operator again. Ideally, we would like NERSA to force a restructuring of Eskom that will remove the present corruption and inefficiency from the electricity system.

Furthermore, the time has come to hold both NERSA and Eskom's leadership accountable for criminal behaviour.

OUTA calls on NERSA to properly exercise its powers to hold Eskom accountable and implement steps to regulate an efficient electricity industry that serves the consumer. If this means amending Eskom's licensing conditions, then NERSA needs to lead from the front.