OUTA

ORGANISATION UNDOING TAX ABUSE

6 September 2019

The R59bn bailout for Eskom

Comment on the Special Appropriation Bill [B10-2019]

OUTA's submission to the Standing Committee on Appropriations

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OUTA COMMENTS ON ESKOM'S SPECIAL APPROPRIATION BILL [B10 – 2019]

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1. Introduction

OUTA envisions South Africa as a prosperous country, with an organised, engaged and empowered civil society that ensures responsible use of tax revenues throughout all levels of government. OUTA is active in the energy sector and has participated in energy-related submissions, for example, on the Integrated Resource Plan, the Carbon Tax Bill, and in the multi-year price determination (MYPD) process of the National Energy Regulator of SA (NERSA) on electricity prices.

In various of those submissions, OUTA has previously recommended that Government urgently intervene at Eskom, inter alia, by reviewing Eskom's outdated business and operating model, that electricity supply industry (ESI) reforms should be initiated without delay, that technical and strategic working groups should be established to address Eskom's sustainability, and that there should be policy and regulatory certainty to attract investments in the ESI.

The reasons for the intended ESKOM financial assistance have been stated as follows:

- Eskom's high levels of debt;
- Eskom's inability to generate sufficient revenue to meet operational and capital obligations;
- Eskom's liquidity and balance sheet risks; and
- Concerns over Eskom's status as a going concern.

This latest bailout comes when there are many demands on the public purse and it is imperative that these funds contribute to the expected electricity sector reform and do not support the non-viable status quo.

Eskom has had two masters in the past, both the Department of Public Enterprises and the Department of Energy (now Minerals and Energy) but has appeared largely to be answerable to neither.

In our view, it is not possible to address the financial sustainability of Eskom without addressing the operational realities.

2. Context of the appropriation

Civil society and other social partners have reiterated over many years the operational and tariff calculation anomalies that have characterised the Eskom tariff applications to NERSA.

Although it might be argued that operational issues are not part of National Treasury's mandate, OUTA believes that government cannot operate in silos and that an understanding of these issues should relate to how Eskom is funded. The following are illustrative of some of the issues which indicate the need for a different management mindset at Eskom.

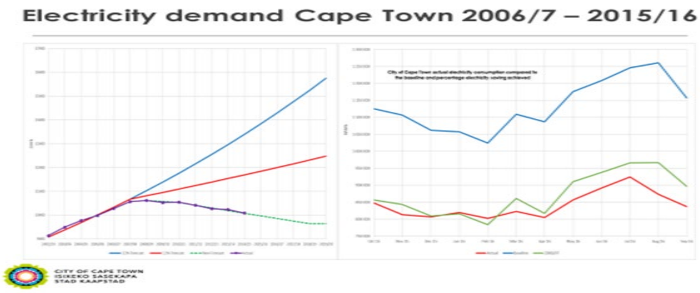
a. Continual price increases beyond inflation

OUTA believes that electricity is an enabler promoting access to improved health, education, security and economic independence. However, the inflationary impact of electricity price increases creates social hardship, including negative effects on food security as people have less income and a lowered ability to obtain sufficient food.[1]

OUTA's research finds that inflation over the last decade[2] was 58.5%. Over the same period, the increase in the average price of electricity charged by Eskom was 261%[3]. Thus, electricity prices increased more than four times more than inflation. Such increases in such an unequal society with many people without an income contribute to deepening of poverty.

b. Unrealistic demand projections

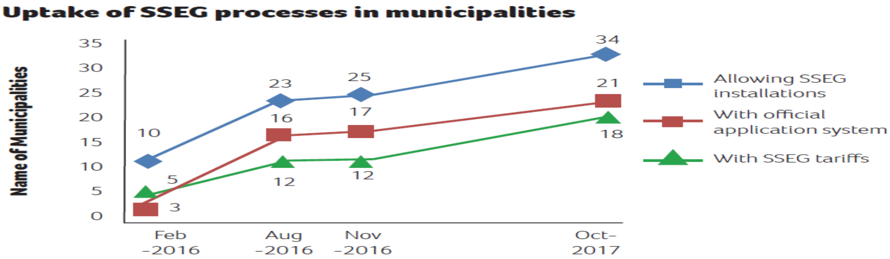
In its MYPD4 electricity pricing application to NERSA of September 2018, Eskom suggests that municipalities form 41% of its customer base and projects that this sector will use more electricity over the next three years. The following slide shows how the City of Cape Town[4] projects its electricity demand. This slide has been consistently presented over many years and Eskom continues to overestimate demand and revenue from local government.



[1] The inflationary impact of electricity price increases impacts on food security https://www.iol.co.za/mercury/news/inflation-continues-to-bite-as-food-prices-ease-17004107
[2] Measured from July 2009 to July 2018
[3] Eskom's statistics for electricity revenue per kWh for the financial years 2008/09 to 2018/19. The Eskom-calculated average price for electricity for 2018/19 at 90.01c/kWh is slightly lower than the NERSA-set average of 93.79c/kWh, so customers may have faced an even higher burden, particularly customers of municipalities.
[4] From the City of Cape Town's submission to NERSA's electricity pricing hearings

c. Emerging technical trends

The emergence of the small-scale embedded generation (SSEG) sector does not seem to have been included in Eskom's planning model. The figure below from the South African Local Government Association (SALGA) [5] shows the increase in rooftop solar PV systems over time. Recent media articles estimate that solar PV rooftop systems grew from an estimated 35MW to 159MW from 2016 to 2017[6].



In our view Eskom is out of touch with reality and has failed to deliver on its mandate for years.

In Parliament, Prof Daniel Plaatjies of the Financial and Fiscal Commission (FFC) has presented a sobering commentary on Eskom:

*"Eskom, in its current form, poses substantial risks to the public finances and economy at large. Eskom is neither financially sustainable, nor capable of meeting the country's electricity needs." (*page 5)

"*The Eskom bailout has the potential to crowd out other infrastructure investments. It is unproductive government spending. The bailout monies will come from somewhere. Obviously there will be reprioritisation or cuts on other expenditure items, which will likely result in service delivery in other areas being negatively affected*." (page 10)

3. Clarify how the bailout will be spent

In Eskom's MYPD4 application, Eskom provides its debt commitment trajectory. Eskom appears to be postponing a shock price hike as there is a large jump in debt repayment in 2022/23 (Eskom MYPD4 page 12). It is not clear how this projection relates to the current appropriation.

TABLE 2: ESKOM DEBT COMMITMENTS

Eskom Debt Commitments (R'm)	Application 2019/20	Application 2020/21	Application 2021/22	Forecast 2022/23	Forecast 2023/24
Debt securities and borrowings repaid	34 115	49 951	49 431	56 085	92 952
Interest paid	39 058	45 115	46 041	49 384	48 607
Total Debt service	**73 173**	**95 066**	**95 472**	**105 469**	**141 559**
Return + Depreciation	47 964	70 154	95 963	111 560	131 192
Variance in debt service cover	**-25 209**	**-24 912**	**491**	**6 091**	**-10 367**

OUTA is concerned that the R23 billion per year allocated in Budget 2019 for the three years of the MTEF (which later emerged as a 10-year plan for assistance) is not mentioned or its effect on Eskom's liquidity position.

[5] From the SALGA submission to NERSA's electricity pricing hearings
[6] https://www.dailymaverick.co.za/article/2016-04-21-rooftop-solar-pv-will-be-a-game-changer/

The Special Appropriation Bill 2019 gives no indication of where the amounts of R26 billion for 2019/20 and R33 billion for 2020/21 the funds would be applied. This should be transparently presented in order to give meaningful comment.

The Eskom Annual Financial Statements (AFS) for 2019 list the debt securities and borrowings as made up as follows:

- Non-current: R387.208 billion
- Current: R53.402 billion (to be serviced in the short-term)

This is a total of R440.610 billion.

The Statement of Financial Position in the AFS 2019 shows this:

- Current assets: R63.994 billion
- Current liabilities: R108.051 billion
- Liquidity shortfall: R44.057 billion

This indicates the immediate funding requirement and includes the current borrowing of R53.402 billion above.

There are various figures presented, and it is not clear how the specific numbers in this Bill have been arrived at (in comparison, for example, with those in the Budget). Providing such clarity would enable a more meaningful submission.

OUTA recommends that the bailout should be apportioned for the following priorities:

- Reducing the current high levels of debt;
- Operational objectives;
- Capital objectives; and
- Improving liquidity and balance sheet risk, which should address the going concern status.

We would like clarity on how Eskom will be operationally sustainable as a result of the R59 billion bailout.

As part of this, it would be prudent to give the public an illustration of the effect after applying the bailout to the Statements of Financial Position and of Financial Performance.

4. Tighten up the conditions

Section 1(2)(b) of the draft Bill stipulates that, for the purpose of promoting transparency and the effective management of the funds, the Minister of Finance, in writing —

(i) may impose conditions to be met by Eskom before any part of the amount is transferred.

Given the history of Eskom bailouts, it would seem prudent to institute certain conditions before any monies are transferred. OUTA recommends that "may" be changed to "must", and that such a condition should be the appointment of the restructuring team at the very least.

(ii) must impose conditions to be met by Eskom after the transfer of any part of the amount.

If Eskom fails to meet such conditions, will National Treasury institute corrective measures?

(iii) must stop the use of any part of the amount in respect of which conditions have been imposed in terms of subparagraph (ii), until such conditions are met.

In order to operationalise this, OUTA recommends that National Treasury provide a practical example that could trigger the Treasury to invoke this provision.

The FFC puts forward a number of recommendations that are largely supported by OUTA. These relate to governance and the need to operationalise a turnaround strategy.

In particular:

- *Establish a performance management framework at Eskom that links the turnaround plan deliverables to Eskom executive and non-executive pay and performance contracts.*
- *Establish clear key performance areas with specific time frames by National Treasury for the Eskom CRO, the Board and Exco.*
- *An oversight framework of Eskom by an adhoc committee of parliament entailing quarterly reports outlining the milestones reached in relation to the prescribed set of performance indicators*
- *A comprehensive legislative and regulatory frameworks by the Department of Energy with timelines and responsibilities for energy transition towards cheaper renewable power generation and associated technologies*
- *A detailed legislative and regulatory framework by the Department of Public Enterprises with timelines and responsibilities for unbundling Eskom into three separate units: generation, transmission and distribution*

OUTA believes that the National Treasury's draft conditions should be published for comment. It is also important that any electricity supply industry (ESI) reform task team report regularly to Parliament on its progress.

As OUTA we appreciate the National Treasury's efforts to hold Eskom accountable, as per the relevant paragraph in the Bill. However, it is a fact that Eskom has failed to abide by obligations imposed by the Public Finance Management Act as disclosed in the findings by the Eskom auditors as reflected in both the 2017/18 and 2018/19 annual financial statements.

What measures is NT putting in place to do its oversight differently this time around?

OUTA recommends that:

i. The terms and conditions that National Treasury is currently drafting must prescribe how the compliance will be enforced, including what appropriate interventions or remedies the Treasury will institute to correct any failures to comply by Eskom;

ii. The Treasury, in collaboration with the Department of Public Enterprises, must instruct Eskom to draft and submit a SMART (specific, measurable, achievable, realistic and time-bound) cost reduction plan with special focus on the key areas that will be trimmed and associated targeted savings;

iii. Eskom must be statutorily obligated to provide a breakdown of how funds will be utilised, including its payment plans to its creditors, interest payments, etc. as a non-negotiable condition before monies are transferred;

iv. The Treasury provides clarity on how long it envisages its financial assistance to Eskom is likely to endure and the expected outcome or effect of this assistance.

v. The Treasury, the Department of Public Enterprises and the Department of Mineral Resources and Energy should set unequivocal timelines for the turnaround of Eskom in line with the envisaged ESI reform agenda.

5. Conclusion

Electricity reduces poverty, improves health, increases productivity and improves standards of living. But it must remain affordable.

The success of the electricity sector reform and Eskom's turnaround strategy will depend on the strength of the oversight that Parliament and the relevant entities' implementation. OUTA is proud to play our role in strengthening Parliament's oversight role.