

**ONE YEAR REVENUE APPLICATION FOR 2018/19- REQUIREMENTS OF CERTAIN MYPD METHODOLOGY  
 AND MIRTA REQUIREMENTS CANNOT BE MET**

**SUBMISSION BY BUSINESS UNITY SOUTH AFRICA (BUSA)**

*May 2017*

**1. INTRODUCTION**

BUSA has consistently made comprehensive submissions to NERSA on Eskom's applications for tariff increases and believes that the integrity of the MYPD methodology is an essential element of the opportunities provided by NERSA for public comment. BUSA remains concerned about the continued tariff increases faced by all sectors of business and has always appreciated the rigour with which NERSA approaches such applications. Transparent information is one of the cornerstones of the MYPD methodology and the Minimum Information Requirements for Tariff Applications. Deviations from the requirements essentially reduce the transparency on and make the decision-making task of NERSA more challenging than it needs to be. The request by Eskom is there a matter of considerable concern to BUSA.

While the current status of Eskom's revenue receipts is well known and understood, it is not considered acceptable that the low demand for electricity should continue to require remaining customers to bear ever increasing costs in order to address the resultant revenue shortfall. While it is recognized that this request only applies to a single year application, BUSA believes that a blanket condonation of non-compliance with the methodology would create a dangerous precedent and considerable care needs to be taken to ensure that sufficient information is provided to substantiate the request and so that the risk of eroding confidence levels is mitigated

BUSA therefore welcomes the opportunity to comment on the above request from Eskom.

This report concerns a request by ESKOM to the National Energy Regulator of South Africa ("NERSA") regarding the One Year Revenue Application for 2018/19 – for which it is argued requirements of certain MYPD Methodology and MIRTA requirements cannot be met by Eskom.

The approach undertaken in this submission is as follows:

- Review of documentation provided by ESKOM and NERSA in this matter as well as the published methodologies and previous applications by ESKOM and previous decisions by NERSA.

- Summary of the relevant provisions of the Electricity Regulation Act; the Electricity Regulations; the MYPD Methodology and ESKOM's licence conditions and the reasonableness of deviation therefrom;
- Assessment of the probable impact of the requested deviation, on a per item basis, on the tariff application

A list of the documents reviewed for this submission are listed in Annexure A.

## **2. SUMMARY OF THE REGULATORY FRAMEWORK**

### **MYPD methodology**

- 2.1 NERSA has employed some form of Rate of Return regulation since its inception, as such methodology was developed in 2003 by its precursor the National Electricity Regulator. The first Multi-Year Price Determination (MYPD) for generation, transmission and distribution was for the period between 1 April 2006 and 31 March 2009. Eskom applied twice in 2007 for re-opening the MYPD. The Energy Regulator approved changes to the MYPD rules in July 2008 and was obliged not to apply certain aspects of the Methodology, such as the asset valuation methodology (Trended Original Cost) from 2009 onwards as a result of the Electricity Pricing Policy.
- 2.2 The Methodology was revised in 2016 after a consultation process. The latest MYPD methodology makes provision for asset valuation using Modern Equivalent Asset Valuation, adjusted for depreciation.<sup>1</sup>

### **The Regulatory Reporting Manuals**

- 2.3 In order to facilitate compliance with the MYPD methodology and to enable the Energy Regulator to determine electricity prices in a consistent manner, a prescribed cost accounting method was required. The Regulatory Reporting manuals were developed during 2007 and approved in 2008, for

*“implementation by licensees for purposes of recording and submitting to the Energy Regulator its financial information, both regularly in a systematic and consistent way. The goal is to have focused financial*

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<sup>1</sup> It must be noted that the use of MEAV in electricity asset valuation is highly unusual, as it is typically used in industries facing a downward Long Run Marginal Cost Curve, so as to incentivise investment in more efficient technology. To use the 'modern equivalent' of an old or outdated electricity plant results in a return on an investment amount that was in fact never made. However, as NERSA has made the MEAV its choice of replacement cost valuation, this point is now moot. NERSA's addition of the use of a Depreciated Replacement Cost in conjunction with the MEAV indicates that in practice its methodology will be closer to a Depreciated Optimised Replacement Value approach, which is closer to the Trended Original Cost method.

information, relevant to economic regulation, which may at times differ from what is contained in statutory financial statements, to enhance efficiency and transparency of the regulatory process.

*RRM not only provides a uniform system of regulatory financial reporting by regulated entities but also requires accounting separation (also known as ring-fencing) (...) as the Energy Regulator may require separating different activities within a regulated entity.”<sup>2</sup>*

2.4 It is worth noting the long history of economic regulation applied to Eskom and the year in which the RRM’s were Gazetted, 2008, nearly a decade ago. NERSA has incorporated the RRM’s into Eskom’s licence conditions, which means that non-compliance with the RRM’s constitutes a breach of licence conditions for which NERSA can impose a fine.

### **Minimum Information Requirements for Tariff Applications**

Pursuant to the Gazetting of the Regulatory Reporting Manuals, NERSA developed Guidelines to assist licensees in compliance therewith, the Minimum Information Requirements for Tariff Applications,<sup>3</sup> for each subsector under its jurisdiction.

The MIRTHA preamble indicates that

*“Recognising that the Energy Regulator has decided as follows:*

*NERSA will issue minimum information requirements that will provide clarity on needed information for tariff applications and act as guidance to the applicant as to the type of information required by NERSA for tariff determination and decision making; and Pursuant to Sections 4(a)(ii), 14(1)(b), 15 and 35 of the Electricity Regulation Act, 2006 (Act No. 40 of 2006) as amended;*

*The following minimum information requirements for tariff applications are prescribed.”* (emphasis added)

Note that the MIRTHA requirements are a minimum threshold for tariff applications, which are prescribed, not optional or voluntary.

### **Licence Conditions**

NERSA incorporated the RRM’s, account separation requirements and the MYPD into the licence conditions in a re-issue of Eskom’s Generation, Transmission and Distribution licences in 2010. The conditions state that Eskom must keep financial records associated with distribution, transmission and generation separate from its other business activities and must furnish NERSA with information as per the RRM’s.<sup>4</sup>

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<sup>2</sup> NERSA, 2008, Regulatory Reporting Manuals; Chapter 1, p6.

<sup>3</sup> NERSA. 2010, Guideline on Minimum Information Requirements for Electricity Tariff Applications, Version 1, 30 August 2010.

<sup>4</sup> NERSA, 2010, Eskom Distribution licence, 25 March 2010.

### 3. ESKOM'S REQUEST FOR CONDONATION

3.1 Pursuant to the adoption of the revised MYPD methodology in October 2016, Eskom requested to deviate from meeting certain requirements on 28 March 2017.

#### **MYPD requirements that cannot be met**

3.2 Eskom states that one 'request' in particular is 'untenable.' This refers to 'providing coal volumes burnt per station, per contract type and per supplier' and Eskom argues it had

*"clarified that this request is untenable. Viable alternatives to achieve the same objectives were provided. These motivations were clarified in Eskom's comments in response to NERSA's MYPD methodology consultation paper (published on 15 April 2016), during the public hearing on the MYPD methodology held on 2 June 2016 as well as in response to the draft MYPD methodology published on 8 September 2016."*

3.3 Eskom goes on to make the following statement in this regard:

*"It needs to be pointed out that the condonation requests related to primary energy will be ongoing, until the methodology is revised."*

NERSA had however instituted this requirement in 2010 (in the MIRTA) for the following reasons:

*"It is recognised that primary energy costs (mainly relating to coal purchases, fuel, water and transport costs) represent the single biggest operating expenditure cost item in the generation of electricity. For this reason, it is important that any cost information, relating to primary energy, submitted for tariff setting purposes is as accurate as possible and includes those costs that were prudently and efficiently incurred. To this end, the Energy Regulator requires information on primary energy costs to be presented in a manner that enables it to perform a rigorous analysis of the costs incurred. This will assist the Energy Regulator to ensure that any tariff setting process takes into account all the relevant Information." (MIRTA p 17)*

3.4 Hence Eskom's assumption that it need not comply with the specific requirements regarding coal cost information and that NERSA will revise the methodology in the regard cannot just be accepted. It is clear from the RRM's and the MIRTA that compliance therewith is compulsory. *"The MIRTA are to be used by all the licensees."* (MIRTA p6)

3.5 The only exception thereto is the gradual implementation to licensees who at the time were not deemed sufficiently ready to implement MIRTA, as outlined in the MIRTA. Eskom does not form part of the list of licensees who would be allowed to use a lighter version of MIRTA.

3.6 Moreover, in the latest version of the MYPD methodology (2016), NERSA states that:

*"Another key risk area was coal procurement. Coal costs have been increasing rapidly and it was not clear where the cost increases were coming from. To enhance transparency the Energy Regulator has amended the rules such that the single cost centre is disaggregated into various contract types because of the different risks per contract type."*

3.7 In fact, the rule is not new at all as it is contained in the MIRTA (“3.4.3.2.1 Coal Purchased and Burnt: Aggregate coal purchases; volumes; price per ton; and costs per contract type; A breakdown of coal purchases; volumes; price per ton; and costs per contract type for each power station”) thereby rendering Eskom’s inability to provide this information even more implausible.

3.8 Below is an itemised response to each section of the MYPD that Eskom has indicated it cannot comply with.

#### 4. RAB VALUATION

Issue	Probable impact on electricity prices	Response
<p>Regulatory Asset Base Valuation</p> <p>Eskom cannot submit a valuation using MEAV as the MYPD methodology stipulating MEAV was only approved in October 2016.</p>	<p>Lower in the short term as MYPD3 valuations will be used.</p>	<p>Accept for the reasons outlined below.</p> <p>NERSA must however provide clarity regarding the frequency of asset valuation interval and the method used for indexation in between such valuation exercises to prevent abuses of the methodology.</p>

4.1 It can be argued that NERSA has been slow in implementing the requirements of the Electricity Pricing Policy, approved and Gazetted in 2008, which made explicit reference to valuation based on replacement costs, stating that “The regulator, after consultation with stakeholders, must adopt an asset valuation methodology that accurately reflects the replacement value of those assets such as to allow the electricity utility to obtain reasonably priced funding for investment; to meet Government defined economic growth.” (emphasis added) The MYPD2 Decision by NERSA (Multi Year Price Determination 2010/11 to 2012/13, of 25 June 2009) took this policy position into account, despite the implied quadrupling or quintupling of the Regulatory Asset Base value of Eskom’s assets.

4.2 In order to smooth the implementation of the sudden increase in asset values, NERSA decided to divide Eskom’s asset base as follows:

*“Eskom’s asset base was divided into two parts i.e. one relating to the existing indexed historic base and the other one relating to the revaluation reserve. It was decided that the revaluation reserve must be phased-in over a period of five years to smooth the price increases.”*

4.3 However, as the EPP places the burden of adopting an asset valuation methodology on the Regulator, the Energy Regulator indicated it would: -

*“Initiate a verification of the replacement value of Eskom’s assets. As a result, the Modern Equivalent Asset Value (MEAV) provided by Eskom has been accepted for the purpose of MYPD2 only, but will be verified during the control period.”*

4.4 In the MYPD 3 decision, NERSA stated the following:

*“In terms of the MYPD2 decision the balance of the Regulatory Asset Base (“RAB”) as at the end of 2012/13 was R911 686m which was to be phased in over five years. The full cost reflective RAB as at the end of 2012/13 was R911 686m which was adjusted to R789 591m due to the decision to phase in the revaluation. The revaluation of the Eskom RAB has however since been completed, such that the closing balance of the RAB as at end of 2012/13 is R709 145m. It is therefore not necessary to phase in the RAB as the revaluation result is similar to the NERSA adjusted value as at the end of 2012/13. Eskom is therefore for the purposes of the MYPD3 allowed to earn a return on the full allowed RAB as determined in line with the provisions of the MYPD methodology.”<sup>5</sup>*

**Table 10: Summary of Approved Regulatory Asset Base**

R'm	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
RAB Applied for	911 686	779 203	852 265	919 662	981 853	1 043 100
RAB Adjustments	(122 095)	(79 594)	(145 874)	(209 712)	(269 073)	(325 587)
RAB Approved	789 591	699 609	706 391	709 950	712 780	717 513

Source: NERSA MYPD3 Reasons for Decision

4.5 Hence it appears NERSA has done an assessment of the MEAV values provided in 2008/9 and has now updated the MYPD methodology to reflect the use of the MEAV method with Depreciated Replacement Cost.

4.6 However, given that the MEAV values were estimated by Eskom in 2009, it may be prudent to index those values for inflation so as to approximate current replacement values and to avoid another price shock at the time of the next revaluation.

<sup>5</sup> The NERSA adjusted value refers to the use of the Trended Original Cost method.

**Impact on prices**

4.7 Eskom believes the continued use of the MYPD3 valuation will mean that the valuation will be ‘conservative.’ This implies that it believes that the asset valuation exercise according to the approved methodology will yield a higher asset value. As the regulator will be subjecting the MEAV valuation to scrutiny, it is not necessarily a given that the valuation will result in an upward adjustment of the RAB. The MYPD3 decision indicates that the revaluation of the asset base approximates the depreciated MEAV value at the end of 2012/13. It is however likely that the MEAV values will be indexed with inflation, giving credence to Eskom’s assertion that the estimate may be ‘conservative.’

4.8 The delay in performing an asset valuation exercise is likely to have a dampening effect on prices in the period 2018/19. Although an MEAV exercise carried out in terms of the prescripts of the MYPD Methodology 2016 may yield lower values than those derived from indexed 2009 MEAV values, it is not likely. Hence the condonation can be granted on the following conditions:

4.9 NERSA must provide clarity regarding the frequency of asset valuation interval and the method used for indexation in between such valuation exercises to prevent abuses of the methodology;

4.10 NERSA must require Eskom to conduct the MEAV exercise within 9 months, so as to be in time for the full MYPD4 application.

**5. RESEARCH COSTS**

5.1 It is noted that research costs are a relatively minor part of the overall allowable revenue.

Issue	Probable impact on electricity prices	Response
<p>Research costs: There must be proper governance procedures in place with industry input in terms of project selection and review.</p> <p>Eskom cannot include inputs from the industry as the MYPD methodology was only approved in October 2016.</p>	<p>Possibly higher due to lack of review of project selection.</p>	<p>Accept if capped at 2017/18 levels plus inflation. The amount for research costs approved in the MYPD3 for 2017/18 is R 257 mln, which is relatively minor in the overall allowable revenue.</p> <p>It is recommended however that NERSA imposes a cap on</p>

		<p>the amount based on previous MYPD approaches and that it enforces adherence to procurement rules for such spending to ensure it is prudently managed. Given the role of the Department of Energy in defining the IRP, it may not be necessary for Eskom to invest in research. Note also questions raised regarding the funding of certain research institutes.<sup>6</sup></p>
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## 6. COAL VOLUMES

6.1 It is noted that coal costs are a relatively large and growing part of Eskom’s primary energy costs and therefore of the overall allowable revenue. The coal costs (excluding coal handling and related costs) approved by NERSA for the year 2012/2013 was R 31.2 bln, whilst the amount applied for applicable to the 2017/18 year was R 56.6 bln (NERSA approved R 49.9 bln). If comparisons are made with previous years’ coal costs the increases are even more pronounced. Hence it is imperative for NERSA to scrutinise and contain these costs where possible.

Coal volumes by station; contract type; and supplier

Issue	Probable impact on electricity prices	Response
Eskom is unable to attribute burn costs and volumes to contract types and suppliers.	Upward pressure due to reduced ability of NERSA to assess the prudence of	Not acceptable. NERSA should be strongly encouraged to enforce the Regulatory

<sup>6</sup> Amabhungane, Eskom funding may be muffling dissenting voices on nuclear, 28 April 2017, available: <http://amabhungane.co.za/article/2017-04-28-exclusive-eskom-funding-may-be-muffling-dissenting-voices-on-nuclear>.

Eskom's coal purchases; coal contracts and cost drivers in primary energy.

Reporting Manuals developed as early as 2008, the MIRTA of 2010 and the relevant conditions of licence.

6.2 BUSA believes that it is not reasonable for Eskom to claim it cannot attribute burn costs and volumes to contract types and suppliers in 2017, given that this requirement was first set in the Regulatory Reporting Manuals, Gazetted as early as 2008, and explicitly stated in the MIRTA for electricity. The MIRTA states the following information is required from electricity (generation) licensees:

*"3.4.3.2.1 Coal Purchased and Burnt*

- *Aggregate coal purchases; volumes; price per ton; and costs per contract type;*
- *A breakdown of coal purchases; volumes; price per ton; and costs per contract type for each power station;*
- *Motivation for having purchased coal on the spot market or plans to utilise the spot market; and measures to ensure these purchases will not be applicable for a period exceeding twelve (12) months;*
- *Transport costs:*
  - o *to be reported as a separate line item for each coal contract type for each power station;*
  - o *provide a detailed explanation for any large and unexpected increases and strategies to control such increases; and*
  - o *the strategies must go beyond the tariff period and the costs identified separately.*
- *Assumptions and summary of indices used for cost escalations and the applicable rates;*
- *The total aggregate production output (in MWh) of coal-fired power stations in total and the production output of each power station;*
- *A statement on the quality of coal burned (calorific value of coal in MJ/kg), and different burn rates (kg coal per kWh produced) per coal-fired power station;*
- *Total average calorific value for each coal contract type;*
- *Projected aggregate coal purchases, including price; volume; quality and burn rate for ten-year period envisaged in the EPP, and a breakdown for each power station;*
- *Detailed explanation and justification for increases and decrease in costs per coal contract type in each power station; and*

- *Stockpile levels and values per power station with planned changes over the tariff period.*<sup>7</sup>

6.3 Non-compliance with the minimum information requirements 7 years after the promulgation thereof raises many questions, which BUSA believes if left unaddressed undermines the integrity and credibility of both Eskom and NERSA. The situation is exacerbated by the allegations (while not yet proven have also not yet been rebutted) of mismanagement; negligence and possible PFMA violations regarding coal contracting as highlighted in the Public Protector’s report “The State of Capture”<sup>8</sup>:

*“It appears that the conduct of Eskom was solely to the benefit of Tegeta, in that they forced the sale of OCH to Tegeta by stating that OCM could be sold alone. Thereafter, it appears, they have allowed Tegeta to proceed with the sale of a portion of OCH in the form of the Optimum Coal Terminal. This may constitute a contravention of section 50(2) of the PFMA in that they acted solely for the benefit of one company.”<sup>9</sup>*

6.4 The Public Protector recommended the following:

*“The President to appoint, within 30 days, a commission of inquiry (...).”*

6.5 The Public Protector Report references a report by National Treasury<sup>10</sup> which indicates that

*“Eskom allowed Tegeta to supply the stockpile coal which did not conform to its standards. There is no evidence to suggest that any remedial action was implemented by Eskom in order to rectify the issues identified with the coal being supplied by Tegeta.”<sup>11</sup>*

6.6 National Treasury required Eskom to submit evidence of effective and appropriate steps taken to ensure that Tegeta:

- a) “Supplied and continue to supply coal that conforms to Eskom’s standards;*
- b) Complied and continue to comply with all obligations under applicable laws;*
- c) Submitted prescribed information to Eskom within 30 days after the publication of the annual report;*
- d) Settled the fine for contravening environmental laws imposed by competent authorities;*
- e) Complied with additional Water Use License requirements;*

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<sup>7</sup> MIRTA, op cit. P18.

<sup>8</sup> Public Protector of SA, 14 October 2016 (released 6 November 2016), “The State of Capture,” available: <http://cdn.24.co.za/files/Cms/General/d/4666/3f63a8b78d2b495d88f10ed060997f76.pdf>.

<sup>9</sup> Public Protector of SA, op cit, p 24.

<sup>10</sup> National Treasury, 12 April 2016, Report on the Verification of Compliance with Treasury Norms and Standards – Appointment of Tegeta Exploration and Resources (Pty) Ltd, cited in Public Protector, op cit.

<sup>11</sup> Public Protector of SA, op cit, p 131.

- f) *Selectively mined the seam, use a grader to remove the major in-seam partings and avoid over drilling and blasting to improve the quality of coal;*
- g) *The Accounting Authority must submit evidence of effective and appropriate steps taken by Eskom after receiving the SABS coal test results dated 18 September 2015 which confirmed that Tegeta's coal do not conform to contracted standards;*
- h) *The Accounting Authority must submit evidence of effective and appropriate steps taken by Eskom after Tegeta justified its high coal price because of the increased BEE shareholding;*
- i) *The Accounting Authority must submit evidence of effective and appropriate steps taken by Eskom to ensure compliance with clause 30 of the Coal Supply Agreement with regards to the submission of the legislative submission associated with compliance by the supplier; and*
- j) *The Accounting Authority must submit evidence of effective and appropriate steps taken by Eskom to ensure that Tegeta was not paid for the tons of coal that did not comply with its standards.*<sup>12</sup>

6.7 Further investigation regarding the award of contracts to Tegeta to supply coal to the Majuba Power Station would form part of "the second phase of the investigation and will possibly be included in the subsequent reports to be released on these matters."<sup>13</sup>

6.8 Regarding Eskom's ability to implement adequate account separation in its financial accounts, it is BUSA's understanding that similar entities in the gas and petroleum pipelines industry have implemented various accounting systems based on SAP in order to comply with the account separation required for the proper regulation of the entities.

6.9 Moreover, it is unclear why Eskom has been able to avoid compliance with the MIRTA requirements as it is recorded in the MIRTA that

*"The purpose of this document is to set out the minimum information requirements for the submission of tariff applications by regulated entities in the electricity supply industry.*

*The aim of the minimum information requirements is to provide applicants licensed by NERSA with an outline of the information to be provided when submitting a tariff application for approval by the Energy Regulator. The minimum information requirements apply to the following licensed activities, namely, generation, transmission, and distribution (wires and trading) respectively for each licensed activity.*

*The Energy Regulator will consider any tariff application complete if it meets all applicable minimum information requirements. Tariff applications that do not meet the minimum information requirements will be referred back to the applicant within two weeks of receipt by NERSA of such an application." (emphasis added)*

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<sup>12</sup> Public Protector of SA, op cit, p 132.

<sup>13</sup> Public Protector of SA, op cit, p 133.

6.10 It is not clear to BUSA why NERSA appears not to have enforced the Regulatory Reporting Manuals, developed as early as 2008, the MIRTA of 2010 and the relevant electricity costs.

**Impact on prices**

6.11 Whilst the impact on prices is speculative, it can be argued that the direction of change is unlikely to be a downwards one. Lack of transparency and accountability regarding fuel costs will hamper NERSA’s ability to monitor such costs and to assess the prudence thereof as required by the MYPD methodology. Despite NERSA’s efforts since as early as the MYPD2 to ensure improved controls on escalating coal costs, Eskom appears intransigent in its compliance with NERSA’s requirements in this regard.

6.12 Moreover, given the investigation by National Treasury into Eskom’s coal purchases and the compliance to procurement rules that are currently ongoing,<sup>14</sup> it would be prudent for NERSA to increase its focus on coal costs, rather than condone non-compliance to enforce the requirements that Eskom has been obliged to meet for nearly a decade.

**7. COAL HANDLING COSTS PER STATION**

Coal volumes by station; contract type; and supplier

Issue	Probable impact on electricity prices	Response
<p>Coal handling costs per activity. Eskom is unable to provide coal handling costs per activity as these costs are not easily ring-fenced or divided into the categories. It is proposed that coal handling costs be reported per power station.</p>	<p>Upward pressure due to reduced ability of NERSA to assess the prudence of Eskom’s coal handling costs.</p>	<p>Acceptable.</p> <p>It appears that the MIRTA actually requires “<i>Stockpile levels and values per power station with planned changes over the tariff Period’ and ‘coal handling cost’, also per power station,</i></p>

<sup>14</sup> Amabhungane, 22 April 2017, R10bn in 15 days – another massive Eskom boost for the Guptas, Available: <http://amabhungane.co.za/article/2017-04-22-r10bn-in-15-days-another-massive-eskom-boost-for-the-guptas>; Business Day, 24 April 2017, Draft report calls for Koko investigation; Treasury review of Eskom’s coal contract with Tegeta wants auditors to look at CEO and chief financial officer; and Eskom, 22 February 2016, Eskom coal and diesel contracts have been made available to the National Treasury, Available: <http://www.eskom.co.za/news/Pages/Feb22B.aspx>.

		<p>not by activity, which Eskom appear to have stated willingness to supply.</p> <p>NERSA should however enforce the Regulatory Reporting Manuals and the MIRTA requirements and scrutinise any significant increases in coal handling costs.</p>
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**8. COST PER STATION OF WATER AND VOLUMES PER PROCESS PER PLANT**

Water cost and volumes per process per plant

Issue	Probable impact on electricity prices	Response
<p>Eskom is unable to determine water usage per process and proposes water usage per power station.</p>	<p>Upward pressure due to reduced ability of NERSA to assess the prudence of Eskom’s water usage costs.</p>	<p>Acceptable.</p> <p>Unless NERSA has prescribed a higher level of information disaggregation since the gazetting of MIRTA, the requirements described exceed the MIRTA requirements which are per station, not per process.</p> <p>It appears that the MIRTA actually requires for “Other Primary Energy Costs at Coal Fired Power Stations” the following:</p>

		<p><u>“Aggregate water purchase cost and volume”</u> and</p> <p>“Water treatment cost.”</p> <p>NERSA should enforce the Regulatory Reporting Manuals and the MIRTA requirements and scrutinise any significant increases water usage costs.</p>
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### 9. WATER TREATMENT COST PER STATION

Water treatment cost - cost of chemicals, electricity and labour - per station

Issue	Probable impact on electricity prices	Response
<p>Eskom indicates that water treatment costs are relatively small and that it does not determine specific electricity and labour costs. The cost of the chemicals and water quality are the main drivers of water treatment cost.</p>	<p>Upward pressure due to reduced ability of NERSA to assess the prudence of Eskom’s water treatment costs.</p>	<p>Not acceptable.</p> <p>NERSA requires costs of water treatment per station and at the very least, the costs of water treatment chemicals and the water input costs must be provided to NERSA. Also, Eskom’s assertion that the water treatment costs are relatively small must be placed in the context of a near doubling of the costs approved for 2012/13 and applied for 5 years later, from R 246 mln approved for 2012/13 to the 2017/18 cost applied for in the MYPD3 of R 477 mln. (NB NERSA approved</p>

only R 316 mln). NERSA should therefore continue to enforce its information requirements regarding these costs.

## 10. MIRTA requirements that cannot be met

10.1 Before moving to the specific MIRTA items that Eskom claims it cannot comply with, it is worth pausing to consider Eskom's statements on the MIRTA. Eskom states that

*"Eskom accepts that MIRTA is not prescriptive. It is a guideline providing direction to the licensee in compiling a revenue application."*

10.2 This is incorrect and misleading. In fact, the MIRTA states the following:

*"The following minimum information requirements for tariff applications are prescribed."*

### *Purpose*

*The purpose of this document is to set out the minimum information requirements for the submission of tariff applications by regulated entities in the electricity supply industry. The aim of the minimum information requirements is to provide applicants licensed by NERSA with an outline of the information to be provided when submitting a tariff application for approval by the Energy Regulator. The minimum information requirements apply to the following licensed activities, namely, generation, transmission, and distribution (wires and trading) respectively for each licensed activity.*

*The Energy Regulator will consider any tariff application complete if it meets all applicable minimum information requirements. Tariff applications that do not meet the minimum information requirements will be referred back to the applicant within two weeks of receipt by NERSA of such an application.' (emphasis added)*

10.3 NERSA provides the legal basis for the MIRTA as follows:

*'Section 35 (1) of ERA allows the Energy Regulator to make guidelines relating to any ancillary or administrative matter appropriate for the proper implementation of the Act. Section 35 (2) refers to the contents of the guidelines. Furthermore, section 14 (1) (b) of the ERA also allows NERSA to prescribe licence conditions that may include, inter alia, furnishing the Energy Regulator with information to perform its functions; the setting and approval of prices, charges, rates and tariffs charged by licensees; and the regulation of licensees' revenue.'*

10.4 It is therefore submitted that NERSA would be well within its rights and moreover has a duty to correct this misconception on Eskom's part. The Regulatory Reporting Manuals and the MIRTA are prescribed and



not optional or somehow open to negotiation. Whilst the MYPD methodology contains provision for deviation from the methodology, the MIRTA contains no such option, and must be complied with.

10.5 In addition, Eskom states that there is a

*“requirement for changes in the Regulatory Reporting Manual Volume 2, the Regulatory Financial Reporting (sic) have been documented and discussed with NERSA over the MYPD3 period.”*

And

*“Eskom understands that NERSA is in the process of reviewing the various modules of the RRM and relevant changes will be made.”*

10.6 BUSA does not believe that Eskom can choose to comply or not comply and certainly cannot prescribe to NERSA that its Regulatory Reporting Manuals or any documents related thereto must be changed. BUSA believes that it is unacceptable for changes in the methodology to be assumed by a licensee in the absence of consultation and a formal decision of the Regulator. NERSA is at risk of being co-opted by Eskom, if not in fact, then possibly in the perception created by Eskom. NERSA is urged to ensure that their independence in making regulatory decisions is maintained and should reassure stakeholders accordingly.

10.7 Below is an itemised response to each section of the MIRTA that Eskom has indicated it cannot comply with.

**11. SEGMENTED CASH FLOW STATEMENTS**

Issue	Probable impact on electricity prices	Response
Segmented Cash Flow statement. Eskom states NERSA has exempted Eskom from providing a segmented cash flow, as this is ‘not feasible at a licensee level.’ NERSA has confirmed this exemption.	Upward pressure due to lack of transparency and reduced ability of NERSA to scrutinise the cash flow statements.	Not acceptable. NERSA should impose a binding timetable on Eskom for account separation and demand segmented reporting as soon as possible.  Moreover, stakeholders should be given an opportunity to make representations when a

		regulatory decision to exempt Eskom from a key provision of its financial reporting obligations is granted by NERSA.
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11.1 BUSA understands ‘segmented’ to refer to disaggregated cash flow and other statements for Eskom’s Generation, Transmission and Distribution activities. Although no records could be found regarding any such exemption by NERSA, BUSA was able to confirm with NERSA that the exemption had in fact been granted. Such decisions should be easily accessible to stakeholders and in this case, should have been reflected in the Explanatory Note.

11.2 Moreover, the statement that *‘this is not feasible at a licensee level’* is unsubstantiated. Other vertically integrated firms have been able to implement the required account separation between regulated activities and have been submitting separate regulatory accounts. Sasol Gas for instance is involved in gas transmission, gas distribution and gas trading, all separate licensable activities and has been able to submit separate accounts for gas transmission and trading, whilst providing details on provincial level sales data. The situation with Eskom needs to be further interrogated.

11.3 BUSA sees no reason by NERSA should not insist on segmented Cash Flow Statements immediately and to consider any delay as a non-compliance with licence conditions, that were enshrined in the RRM as early as 2008 and in the MIRT as early in 2010.

## 12 FINANCIAL INFORMATION PROJECTIONS

Issue	Probable impact on electricity prices	Response
Eskom claims that projections for years beyond the application cannot be provided as there is <i>‘uncertainty in the industry policy environment’</i> such as the <i>“review of independent (sic) integrated resource plan, significant changes in the available capacity and uncertainty on the independent power purchase programme.”</i>	The lack of a multi-year price application and a long forecasting period can have two, equally undesirable, outcomes. Either the short-term view yields an average price that is below that required for the longer-term supply of electricity, resulting in a price shock in the next MYPD period; or, the	Not acceptable for the reasons outlined below. Eskom should at the very least be compelled to provide a ‘business as usual’ forecast.

average price is higher than is required for the longer-term supply situation, leading to unnecessary hardship for consumers in the coming year.

- 12.1 Uncertainty in the policy environment has existed since the first discussions of reform in the mid-1990s, but has never and cannot be considered a reason not to plan and forecast for the long term. At least Eskom should provide a ‘business as usual’ forecast.
- 12.2 Similarly, the Integrated Resource Plan has been reviewed before, and should there be significant changes to Eskom’s role in new generation capability or other functions, the MYPD methodology contains provisions for re-openers and the Regulatory Clearing Account, during which discrepancies can be addressed.
- 12.3 In addition, the ‘*significant changes in the available capacity*’ were within Eskom’s knowledge, if not full control, and capacity additions and changes to the maintenance schedule cannot result in Eskom’s inability to forecast.
- 12.4 Likewise citing the ‘*uncertainty on the independent power purchase programme*’ as an excuse to not comply with information requirements is not considered valid. As far as BUSA is aware Government has clearly stated its policy position in this regard. Notwithstanding this view, BUSA does believe that a greater degree of alignment between the IPP programme and Eskom needs to be established as a matter of urgency. In this regard, a business as usual forecast could at least provide some of the required information.

### 13 ASSET BY ASSET CLASS

Issue	Probable impact on electricity prices	Response
Eskom claims it is not able to provide data per the asset classes as prescribed in the MIRTA templates. Instead, Eskom states matter-of-factly that “ <i>Asset classes will be provided as per the classes contained in Eskom information (e.g. Gx per technology).</i> ”	Upward pressure due to reduced ability of NERSA to assess the details and accuracy of Eskom’s assets and their valuation.	Not acceptable. NERSA should enforce the Regulatory Reporting Manuals developed as early as 2008, the MIRTA of 2010 and the relevant

		conditions of licence regarding asset registries.
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13.1 Eskom’s apparent intransigence in this regard should surely be dealt with by NERSA in terms of the relevant provisions. It should not take a decade to classify the assets into prescribed asset classes, regardless of how large or vertically integrated the company in question is. Although it is recognised that historical condonation of this non-compliance could have contributed to Eskom’s current position, it is recommended that NERSA insist that Eskom develops a compliant asset register within a fixed time period and to consider any overruns as non-compliance.

**14. ASSETS**

<b>Issue</b>	<b>Probable impact on electricity prices</b>	<b>Response</b>
<p>Eskom indicates it will base its <i>“historical assets on Eskom historic asset base as reflected in AFS (...). The replacement asset base will be addressed under the MYPD methodology.”</i></p> <p>These particular sentences do not make sense. We surmise however, that Eskom has indicated it will base the asset valuation on historical costs in this one-year price application and that the replacement costs will be estimated in the next MYPD4 application.</p>	<p>Not clear as the request is not clear.</p>	<p>Not acceptable.</p> <p>Firstly, NERSA should ask Eskom to rewrite this part into an intelligible request as the manner in which it is put in the letter is open to interpretation and therefore likely to lead to misunderstandings.</p> <p>Secondly, if BUSA’s understanding of Eskom’s request is correct (which is far from certain) the idea of asset valuation on a historical cost basis after the MYPD3 was based on an MEAV valuation is nonsensical. The subsequent reduction in the RAB would</p>

		<p>yield a lower average electricity price in 2018/19, which would inevitably result in a disproportionately high increase the years thereafter.</p> <p>NERSA should enforce the Regulatory Reporting Manuals developed as early as 2008, the MIRTA of 2010 and the relevant conditions of licence regarding asset registries and valuations.</p>
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**15. CAPITAL EXPENDITURE**

**Capital expenditure**

<b>Issue</b>	<b>Probable impact on electricity prices</b>	<b>Response</b>
<p>Eskom states it does not reflect its capex values as per the asset classes as prescribed in the MIRTA templates and will not be in a position to provide the information. It will <i>“not be in a position to provide ten-year forecast (sic) per asset class due to uncertainties.”</i></p> <p>Instead, Eskom states it will provide the information per business category and per project.</p>	<p>Upward pressure due to reduced ability of NERSA to assess the details and accuracy of Eskom’s capital expenditure.</p>	<p>Not acceptable. Eskom cannot choose not to record its assets in the format prescribed. NERSA has prescribed these formats so as to provide it with the information it needs in order to take informed and accurate decisions.</p> <p>NERSA should be strongly encouraged to enforce the Regulatory Reporting Manuals developed as early as 2008, the MIRTA of 2010 and the</p>

relevant conditions of licence regarding asset registries.

### Asset disposals and impairments

Issue	Probable impact on electricity prices	Response
<p>Eskom states it will not be in a position to “provide details on each asset disposed etc.; assume it will only be for big ticket items.”</p>	<p>Upward pressure due to reduced ability of NERSA to assess the details and accuracy of Eskom’s regulated asset base.</p>	<p>Not acceptable. Eskom cannot refuse to provide details on asset disposal. At the very least it should propose a level of materiality if it is applying for a deviation.</p> <p>NERSA should enforce the Regulatory Reporting Manuals developed as early as 2008, the MIRTA of 2010 and the relevant conditions of licence regarding asset disposal record keeping.</p>

### 16. DEPRECIATION

Issue	Probable impact on electricity prices	Response
<p>Eskom indicates it is not able to provide the depreciation data per asset on a historical cost and replacement cost basis as prescribed in the MIRTA templates.</p>	<p>It is not clear how NERSA can determine an accurate allowable revenue amount without precise depreciation data. It is likely to lead to inaccurate</p>	<p>Not acceptable.</p> <p>NERSA should enforce the Regulatory Reporting Manuals</p>

	pricing at best and inflated prices at worst.	of 2008, the MIRTA of 2010 and the relevant conditions of licence regarding depreciation values.
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### 17. DEFERRED DEBITS AND CREDITS

Issue	Probable impact on electricity prices	Response
<p>Eskom indicates it cannot provide deferred debits and credits as the RCA decision is awaiting legal outcomes.</p> <p>(NB note that 'Deferred debits and credits' refer to prepayment of rent, insurance etc. for instance, not regulatory assets and liabilities arising from regulatory decisions.)</p>	<p>The lack of detail on deferred debits and credits may not have a substantial impact on the price application, but is nevertheless likely to lead to inaccurate pricing at best and inflated prices at worst.</p>	<p>Not acceptable.</p> <p>NERSA should enforce the Regulatory Reporting Manuals of 2008, the MIRTA of 2010 and the relevant conditions of licence regarding depreciation values.</p>

### 18. SALES REVENUES AND DEMAND FORECASTS

Issue	Probable impact on electricity prices	Response
<p>Eskom claims it cannot provide sales volumes between regulated and non-regulated business and cannot provide sales volumes for some of the categories prescribed in the templates.</p>	<p>The lack of a multi-year forecast and a ten-year sales projection can have</p>	<p>Not acceptable.</p>

In addition, due to ‘uncertainty’, it is unable to provide projected sales to support the ten-year price path.

two, equally undesirable, outcomes.

Either the short-term view yields an average price that is below that required for the longer-term supply of electricity, resulting in a price shock in the next MYPD period; or, the average price is higher than is required for the longer-term supply situation, leading to unnecessary hardship for consumers in the coming year.

The recording of sales volumes between regulated and non-regulated business should be a matter of routine. Eskom essentially has very little unregulated electricity sales and NERSA should provide clarity on this matter to stakeholders. It has been argued that the price of exported MWh is unregulated, which is untenable in the context of NERSA’s mandate to regulate electricity prices, as for instance subsidising exports by domestic sales should not be acceptable to NERSA.

NERSA should enforce the Regulatory Reporting Manuals of 2008, the MIRTA of 2010 and the relevant conditions of licence regarding depreciation values.

18.1 The Energy Regulator has made it very clear that accurate sales projections are of pivotal importance to sound price setting. Paragraph 1.3 of the MYPD methodology (2016) states the following:

*“A major risk factor that was highlighted was the inaccuracies in sales volumes projections, as well as plant availability projections. Sales volume variations have been one of the largest components of Revenue Variance in the previous RCA and the rules have been revised to deal with this problem. Furthermore, a new section, namely ‘Production Plan’, has been introduced for alignment and to improve transparency.”*  
(emphasis added)

18.2 The ‘uncertainty’ that Eskom faces is not new and should not be used as a justification for not providing business-as-usual sales projections.

**19. A COAL PURCHASE AND BURNT**

**Aggregate coal purchases; volumes; price per ton; and costs per contract type**

Issue	Probable impact on electricity prices	Response
<p>Eskom indicates coal burn is not available per contract type and that <i>‘coal cannot physically be separated into categories when it is burnt. The burn cost is calculated on a weighted average cost.’</i></p>	<p>Higher prices due to lack of transparency and inability of the Regulator to probe coal costs due to lack of information. Given the comments earlier in this document, BUSA agrees with NERSA that coal costs are a critical component of the electricity price and require accurate reporting as well as careful scrutiny.</p>	<p>Not acceptable.</p> <p>BUSA is not convinced that coal cannot be separated into categories and if NERSA accepts that this is in fact the case then it must provide Eskom with a clear indication of what should be done. Surely it is possible to record what coal is purchased per contract and per category per power station, which together with inventory changes allows for an accurate estimation of coal burnt values.</p> <p>NERSA should enforce the Regulatory Reporting Manuals of 2008, the MIRTA of 2010 and the relevant conditions of licence regarding coal costs, which if anything, have become more important over the past decade.</p>

19.1 BUSA does not believe that it is reasonable for Eskom to claim it cannot attribute burn costs and volumes to contract types and suppliers in 2017, particularly given that this requirement was first set in the



Regulatory Reporting Manuals, Gazetted as early as 2008, and explicitly stated in the MIRTA for electricity. The MIRTA states the following information is required from electricity (generation) licensees:

*“3.4.3.2.1 Coal Purchased and Burnt*

- *Aggregate coal purchases; volumes; price per ton; and costs per contract type;*
- *A breakdown of coal purchases; volumes; price per ton; and costs per contract type for each power station; (...)*
- *A statement on the quality of coal burned (calorific value of coal in MJ/kg), and different burn rates (kg coal per kWh produced) per coal-fired power station;*
- *Total average calorific vale for each coal contract type;*
- *Projected aggregate coal purchases, including price; volume; quality and burn rate for ten year period envisaged in the EPP, and a breakdown for each power station;*
- *Detailed explanation and justification for increases and decrease in costs per coal contract type in each power station; and*
- *Stockpile levels and values per power station with planned changes over the tariff period.”<sup>15</sup>*  
(emphasis added)

19.2 NERSA instituted this requirement in 2010 (in the MIRTA) for the following reasons:

*“It is recognised that primary energy costs (mainly relating to coal purchases, fuel, water and transport costs) represent the single biggest operating expenditure cost item in the generation of electricity. For this reason, it is important that any cost information, relating to primary energy, submitted for tariff setting purposes is as accurate as possible and includes those costs that were prudently and efficiently incurred.”*

19.3 BUSA agrees with NERSA that primary energy costs are the largest operating expenditure cost item, and that information must therefore be as accurate as possible.

**20. COAL TRANSPORT COSTS**

Issue	Probable impact on electricity prices	Response
Coal transport costs are to be reported as a separate line item for		

<sup>15</sup> MIRTA, op cit. P18.

<p>each coal contract type for each power station; detailed explanations for large increases are required; Coal handling costs must be provided.</p> <ol style="list-style-type: none"> <li>1. Eskom claims it cannot provide transport cost (rail and road) for ST/MT purchases, but provides no justification.</li> <li>2. Eskom claims that where coal is transported by conveyor the cost is included in the coal price.</li> <li>3. Lastly Eskom asserts that coal handling costs cannot be provided per activities and proposes this is instead reported power station.</li> </ol>	<p>Higher prices due to lack of transparency and inability of the Regulator to probe coal costs due to lack of information. Given the comments earlier in this document, BUSA agrees with NERSA that coal costs are a critical component of the electricity price and require accurate reporting as well as careful scrutiny.</p>	<ol style="list-style-type: none"> <li>1. Not acceptable. The requirement is one of simple bookkeeping and checking contractual amounts, which any prudent company would do as a matter of course.</li> <li>2. Conveyor costs may be included in the coal price. The inclusion of such costs must however have some basis and it is proposed that the contractual agreements pertaining to the inclusion of the conveyor cost in a bundled coal price be provided to and scrutinised by the regulator. On that basis, it is acceptable.</li> <li>3. NERSA should consider allowing the information to be submitted per power station.</li> </ol>
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## 21 ENVIRONMENTAL LEVY

Issue	Probable impact on electricity prices	Response
<p>Eskom claims that whilst environmental levy costs are ring-fenced per power station per month, revenues are not. It further states that levy costs are embedded in the total revenue recovery of the generation division,</p>	<p>Higher prices due to lack of transparency and inability of the Regulator to probe levy costs and revenues.</p>	<p>Not acceptable. The requirement is one of simple bookkeeping similar to VAT payments, which any prudent</p>

claiming that “Generation cannot report on ring-fenced levy revenue at Generation level.”

company would do as a matter of course.

As far as BUSA is aware, the power stations are individually licensed with SARS for the environmental levy. Each licensee is required to demonstrate the revenue on which the levy is calculated.

20.2 In June 2015 BUSA made representations to NERSA in the public hearings regarding Eskom’s request for a ‘selective reopener’ to the MYPD3 and indicated the following:

*“BUSA is opposed to the imposition of the environmental levy per se, and strongly opposes an increase therein.*

*We understand that this is imposed by the Minister of Finance and we request NERSA to play an active role in ensuring the collected levies are accounted for properly. We propose that:*

*The levy should not become part of the new ‘base price’;*

*Levy collections and payments by Eskom must be ring-fenced and monitored strictly by NERSA;*

*A mechanism for annual reconciliations and claw backs must be introduced; and*

*The levy must be shown separately on consumers’ accounts”<sup>16</sup>*

20.3 BUSA is concerned that the imminent imposition of a carbon tax on Eskom will further complicate this situation and requests that NERSA engages with Eskom and stakeholders on a way which will ensure transparency of the revenues on which the levy is paid and the amount ESKOM pays to SARS. It is not clear to BUSA why it is not possible to ring fence the environmental levy and urges NERSA to try and find a solution to the challenge presented by the apparent inability to accurately reflect the revenue on which the levy is payable and the amount paid. In this regard, NERSA may recall that the BUSA submission in 2015 identified a discrepancy between the levy paid and what should have been paid.

<sup>16</sup> BUSA, 2015, Eskom 2015 MYPD Reopener; Submission to NERSA; June 2015.



## **21 CONCLUSION**

21.1 As is clear from the above comments, BUSA is not willing to support a blanket condonation of the request for deviation from the methodology or the MIRTA. It is particularly problematic for organised business to support what is essentially a request for non-compliance to be condoned.

21.2 All electricity customers, large and small, rely on NERSA to balance the interests of all stakeholders and to protect captive customers from a situation where a vertically-integrated near-monopoly can have price increases considered without the prescribed information being provided.

21.3 BUSA urges NERSA to not to accede to the blanket request and to take into consideration the views of stakeholders in this regard in order to demonstrate its commitment to the fulfilment of its mandate as an independent regulator.

BUSA recognises the urgency to take this decision but believes that the matter is so serious as to have warranted public debate, rather than just written comment. In future, such requests should be the subject of public hearings and be published for comment as soon as possible after receipt of the request. In order to facilitate this, clear timelines should be provided for licensees to submit such applications.

## **ANNEXURE A**

### **List of documentation reviewed**

Below is a list of documentation reviewed in the compilation of this report.

- NERSA, Regulatory Reporting Manual; Volume 1, General Regulatory Reporting Procedures and Administrative Matters, 31 July 2008, GG September 2008.
- NERSA, Regulatory Reporting Manual; Volume 2 Electricity, 31 July 2008, GG September 2008.
- Department of Energy, 2008, Electricity Pricing Policy, GG 19 December 2008
- NERSA, undated, Multi-Year Price Determination (MYPD) Methodology (post 2009)
- NERSA, 2010, MYPD2 Reasons for Decision, February 2010
- NERSA, 2010, Eskom Distribution licence, 25 March 2010
- NERSA, 2010, Guideline on Minimum Information Requirements for Electricity Tariff Applications, Version 1, 30 August 2010 (“MIRTA”)
- NERSA, 2010, MYPD3 Reasons for Decision, February 2013
- NERSA, 2015, Reasons for Decision, regarding Eskom’s Selective Re-opener of the MYPD3 application for OCGTs and STPPP and impact of increase in Environmental Levy, 29 June 2015.
- NERSA, 2016, Multi-Year Price Determination (MYPD) Draft Methodology, published on 8 September 2016
- NERSA, 2016, Multi-Year Price Determination Methodology, published October 2016.
- Public Protector of SA, 14 October 2016 (released 6 November 2016), “The State of Capture,” available:  
<http://cdn.24.co.za/files/Cms/General/d/4666/3f63a8b78d2b495d88f10ed060997f76.pdf>.