

2017

## EIUG Comment on Eskom's Revenue Application for 2018/19

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# WHO WE ARE

1

The Energy Intensive User Group of Southern Africa (EIUG) is dedicated to the promotion of the interests of energy intensive users in South African Industry.

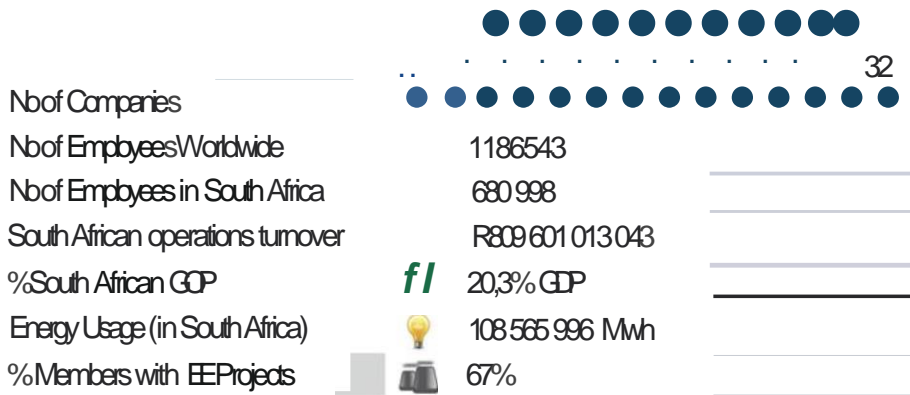


### KEY FOCUS AREAS

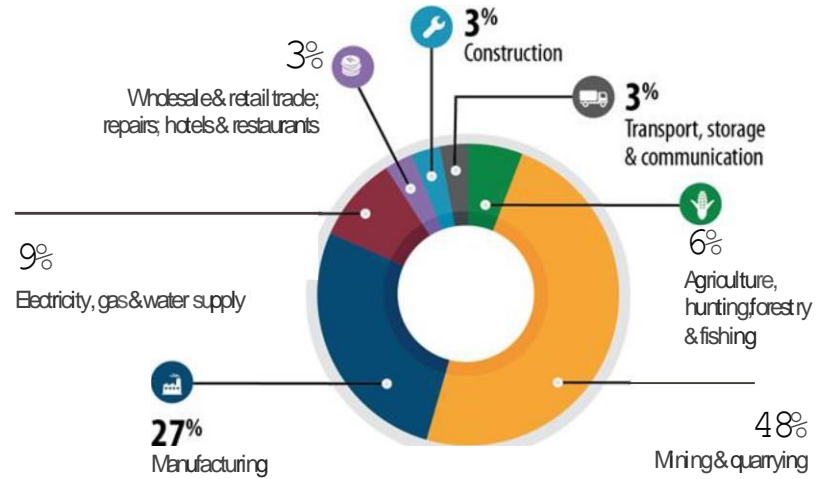
- Affordable and Sustainable energy pricing
- Security of Supply
- Quality of Supply

Established in 1999, the EIUG is a voluntary, non-profit association of energy intensive consumers whose members currently account for over 40% of the electrical energy consumed in South Africa. Our members collectively contribute over 20% to the GOP of South Africa.

The EIUG has significant technical expertise on energy matters. It is a respected and non-partisan organisation dedicated to working towards a sustainable energy supply industry.



### CURRENT MEMBERS CONTRIBUTE TO THE FOLLOWING SECTORS



There is no sector limitation for membership and we try get an as diverse array as possible

### ELECTRICITY COSTS % OF ANNUAL EXPENDITURE



1001 = Total expenditure per SKO

# KEY MESSAGES

2



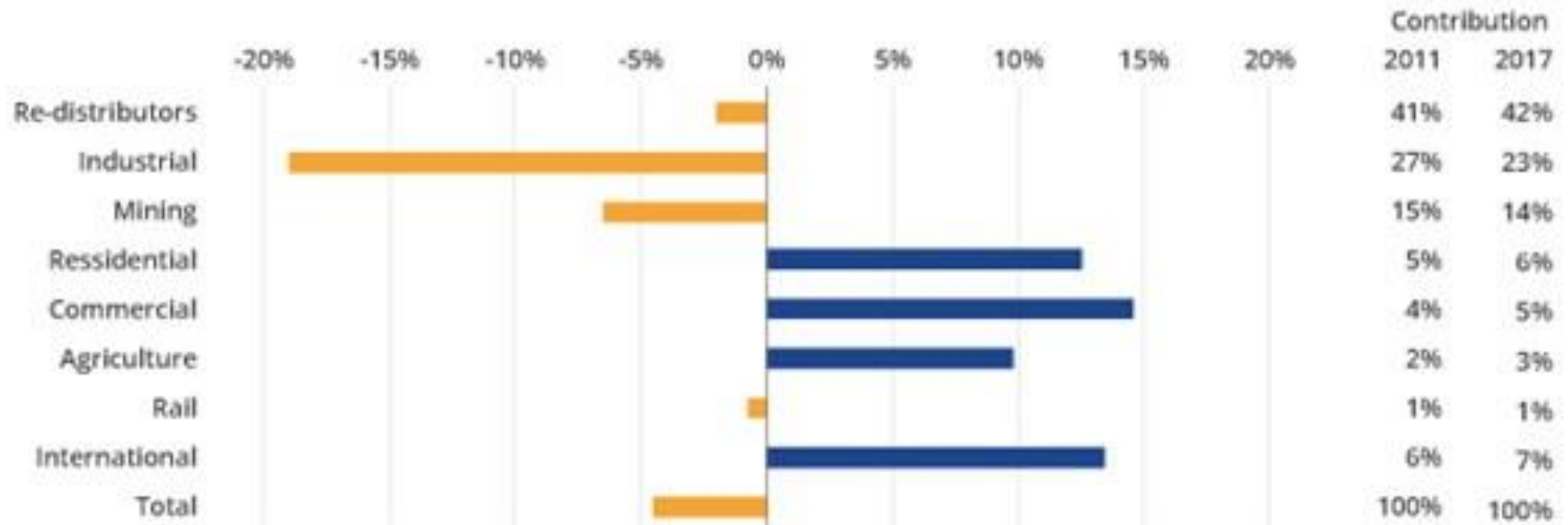
# Key Messages

- Eskom's Single Year Revenue Application of a 19.9% increase in price is unacceptable and will result in the partial or full closure of industry/mining plant capacity, and migration of investment to zones that are more competitive and offer more electricity price certainty and an increase in unemployment.
- We strongly urge NERSA to grant Eskom only a CPI increase, and to waive the three outstanding RCAs entirely.
- Eskom must immediately engage in internal aggressive cost-cutting as well as addressing the manifest operational inefficiencies and gross irregular expenditure.
- In addition, it is crucial that Eskom addresses the overwhelming reports and disclosures of maladministration, as well as allegations of corruption and governance failures.

## KEY MESSAGE 1

Eskom's Single Year Revenue Application of a 19.9% increase in price is unacceptable and will result in the partial or full closure of plant industry/mining capacity, and migration of investment to zones that are more competitive and offer more electricity price certainty, and an increase in unemployment.

## ESKOM SALES GROWTH BY CATEGORY - 2011 TO 2017



### *Electricity Volumes % Growth / (Decline) & Contribution*

- The rate of deterioration of the industrial and mining sectors in South Africa is alarming. This is evidenced by the steady decline in Eskom's sales to these sectors which, combined for 2017, are more than 14% below 2011 levels.
- This is due mainly to industrial and mining capacity shutting either permanently or temporarily, or moving offshore. Unfortunately, without immediate and sustainable intervention, it is unlikely this downward trend will change.



## 19.9% Increase Will Result in a Death Spiral

- Excess capacity can be attributed to reduced demand and aggressive plant efficiency improvements to avoid load shedding, which in turn is, in part due to higher electricity prices.
- Price increases of 19.9% per annum will trigger an exodus of energy intensive industries, or new investment in embedded generation and rooftop PV which will lead to a sharp fall in Eskom sales and a “death spiral” scenario where high price increases and grid defection feeds on each other. This trend has been witnessed globally and has resulted in financial crises at several large utilities.
- In such a scenario, all customers will have to pay more for electricity, which will trigger further unintended outcomes, such as lower GDP growth, less job creation, job losses and additional non-technical losses.

# Arresting the Death Spiral

- Eskom's initiative to implement a Short-Term Incentive Tariff to enable closed or mothballed industrial plant to reopen is supported. In parallel Eskom must move to cost-reflective tariffs for energy intensive industries and the EIUG supports Eskom's plans to implement the EIICT, for the immediate need to increase sales and stabilise the income for Eskom.
- The achievement of a stand-alone investment grade rating should no longer be Eskom's goal in a rapidly changing energy environment where the cost of renewable technologies and flexible generation options offer cleaner and cheaper alternatives.
- The focus should rather be on how to restructure Eskom's current generation business and find the middle ground to manage the coming energy transition with as little pain as possible. Eskom should learn from those global utilities that have faced the same issue and act accordingly.
- The EIUG therefore believes that this single year revenue application should be viewed against the broader background of Eskom's business model becoming unsustainable, and as a country a way forward must be found to prevent de-industrialisation.

## KEY MESSAGE 2

Eskom should receive only CPI increases for the next few years to force Eskom to focus on efficiencies and corporate governance.

# Eskom Governance and Efficiencies

- The manifest operational inefficiencies and gross irregular expenditure must be considered when evaluating this application.
- The overwhelming reports and disclosures of maladministration, allegations of corruption and governance failures, have had an enormous impact on Eskom's reputation and must also be considered.
- Eskom's historic practices lead us to believe that Eskom will not reform and become an efficient entity in the current environment.
- The pricing model is fundamentally flawed in that Eskom assumes that prices must increase, higher than expected sales will realise in an effort to fund expenses instead of focusing on reducing costs and quantifiably increasing efficiencies.
- Eskom should receive only CPI increases for the next few years to force Eskom to focus on efficiencies and corporate governance.
- Eskom must immediately engage in internal aggressive cost-cutting.
- The three outstanding RCAs should be waived entirely.

## KEY MESSAGE 3

Eskom must immediately engage in internal aggressive cost-cutting as well as addressing the manifest operational inefficiencies and gross irregular expenditure.

## Aggressive cost cutting measures

- The total energy available for distribution, coupled with the decline in sales, raises concerns regarding the level of overstaffing at the utility. This issue has been highlighted in the World Bank Study for Utilities in Africa.
- The World Bank Study of Utilities in Africa considered the staffing data for 36 countries. Staff costs represent a significant portion of operating costs for a utility: on average US\$27,000 per employee, per year in constant 2014 US dollars. This result is heavily skewed by the South African utility staff costs, at an average of US\$61,000 per employee.
- According to the World Bank, Eskom stands out for overstaffing in absolute terms, reporting 41,800 employees against the estimated benchmark of 14,200. This suggests overstaffing of 27,500.
- The customer should not bear the burden of policy decisions, for example; using SOE's to create employment. Eskom cannot be both a vehicle for stakeholder policy, and operate as a for-profit enterprise.

## KEY MESSAGE 4

It is crucial that Eskom addresses the overwhelming reports and disclosures of maladministration, as well as allegations of corruption and governance failures.

# Governance

- The overwhelming reports and disclosures of maladministration, allegations of corruption and governance failures, have had an enormous impact on Eskom's reputation and must be taken into consideration and dealt with by NERSA.
- South Africa cannot afford the social and economic ramifications of corruption. Corruption undermines our economic and social potential. Together with government, organised labour, and community, we must commit to restoring good governance and decisively acting against corruption



# RECOMMENDATIONS

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# General Recommendations

- A structural reform in the energy sector, and of Eskom is needed.
- Eskom must plan more conservatively, engage with their customer base in forecasting demand and plan to be flexible in their supply strategy.
- Assuming no other changes other than the number of employees and a fixed cost per employee, Eskom would achieve an acceptable CFROI when the number of employees drops below 30 000.
- Incentives in the form of bonuses are intended for efficient, well-performing organisations. Labour costs related to bonuses should be reconsidered based on above statement.
- Eskom must provide further data and explanation on their Primary Energy costs and assumptions.
- No costs for Bid Windows 4 and 4.5 should be included in this application as none of these projects will be realised during the period covered in the application.
- Eskom must provide clear rationalisation regarding capital expenditure projects.

# Short Term Recommendations

- Eskom's initiative to implement a Short-Term Incentive Tariff to enable closed or mothballed industrial plant to reopen is supported. In parallel Eskom must move to cost-reflective tariffs for energy intensive industries and the EIUG supports Eskom's plans to implement the EIICT.
- Negotiated Price Agreements (NPAs) for 2 years supported to increase sales in the short-term.
- The three outstanding RCAs should be waived entirely.
- Cross-subsidies in the tariffs should be reviewed under a national framework.
- Eskom should receive only CPI increases for the next few years to force Eskom to focus on efficiencies and corporate governance.
- Eskom must immediately engage in internal aggressive cost-cutting.

# Long Term Recommendations

- Eskom must restructure and the industry must change its business model as it is no longer sustainable, given the new environment in which Eskom operates and the increasing competition of alternate electricity supply. Ways in which Eskom could restructure, some of which are already included in government policy, are:
  - o Early decommissioning of older, less-efficient (emissions and operationally) stations, or mothballing/cold reserve;
  - o Split up Eskom's operations into Generation and Transmission and Distribution with an independent system operator and buyer, to foster competition; and
  - o Private sector participation – IPP's and selling power stations to the private sector.

Re a leboha

Ro livhula

Siyabonga

Ha khensa

• Enkosi

Siyathokoza

Dankie

• Thank  
you