groundWork comment on Eskom regulatory Clearing Account (RCA) submission to the National Energy Regulator of South Africa (NERSA).

22 January 2016

1. Process

Eskom's requests for grossly inflated tariff hikes come round every year or, as in 2015, more than once a year. It has established a pattern of late and/or repeated application stretching back to 2008. This has the appearance of a tactic to forestall public consultation and put NERSA's decision making under pressure.

The MYPD 3 decision gave Eskom an 8% annual increase for five years from March 2013-18. This was half Eskom's request for a 16% annual hike. In 2015, Eskom submitted an RCA request for an additional 10% or so to give an overall rise of 18%. Nersa awarded 4.69%, taking the total rise for the year to 12.69%. This year, Eskom is asking for about 8.6% to bring the total to 16.6%.

It thus appears that Eskom is using the RCA mechanism to restore the increases demanded in its original MYPD 3 application.

2. Background

Since 2008, Eskom has asked for extraordinary increases to pay for its new build programme and for escalating fuel costs. We have long since argued that the new build was ill considered. It took no account of climate change, the costs to people's health or the environment from the power plants or the coal mines that supply them. It also courted the risks of gigantism: very large plants are commonly over time, over budget, open to corruption and, particularly in South Africa, vulnerable to currency volatility. Eskom chose to ignore or downplay these risks. It also ignored the fuel price escalations and volatility resulting from the depletion of conventional oil resources and of the coal resource in South Africa itself and its intersection with global economic depression. Eskom is now caught with the consequences of its own arrogance.

The very large base load plants are primarily designed to supply very large energy intensive industries. This is the energy regime that developed in the 20th Century and which Eskom and big industry wished to reproduce in the 21st Century. We believe that the bill for the escalating costs of these plants should be sent to the industries that demanded big base load. These industries included some of the richest transnational corporations in the world and they have been subsidised by the rest of the South African economy by getting power at below production costs. These corporations have also had direct and privileged access to decision making.

The model of big baseload plants to supply big energy intensive industries is now collapsing under the costs of trying to reproduce it and is pulling the country down with it. In 2010, Nersa justified the MYPD2 decision to give Eskom 25% a year on the grounds that South Africa needed another 10 GW by 2016 to keep its energy intensive economy fired up.[1] 2016 has come, Eskom's capacity has contracted by 5 or 6 GW, demand has slumped, the commodities bubble has burst, the big TNCs have taken their profits offshore and are abandoning their liabilities, the coal regions are further down the road to environmental ruin and the world is on track for 4 degrees warming.

3. Eskom's case

The RCA allows Eskom to recover prudently incurred costs. In our view, there has been nothing prudent in what Eskom has done over the last decade. One poor decision has led to the next and, even as new build cost escalate, is compounded by flagrant flouting of governance norms. Instances include the boiler contract, for which Hitachi was penalised by the US Securities & Exchange Commission, and giving coal contracts to mines which are short of water or environmental approvals. The imprudence governing Eskom is reflected in the merry-go-round of Board and top management.

Imprudence is also reflected in Eskom's disdain for minimum emission standards. The corporation knew they were on the way from 2005 when the Air Quality Act was passed and preferred to stonewall implementation rather than proactively prepare for it. The externalised costs are knowingly imposed on neighbouring communities.

[1] Zweli Mokgata, *Eskom's regulator defends unpopular tariff increases 'SA needs 10000MW by 2016'*, Sunday Times, 7th March 2010.

The main items for which Eskom seeks compensation are: low sales; coal and diesel costs, and IPPs.

Low sales: Eskom specifically excludes loss of sales due to loadshedding. Hence, this reflects reduced demand caused, in part, by rocketing prices. It is not evident why households should pay more just because Eskom has sold less than it forecast. We have for some time observed that Eskom (and IRP) forecasts are ridiculously high, apparently to justify building plants that we will not need. As it is, reduced demand saves increased loadshedding.

Since capital spending is a primary driver of cost increases, an intense focus on energy efficiency and demand management would seem appropriate. It is notable, however, both that the MYPD3 targets are extremely modest and that Eskom has underachieved and underspent. Should Eskom complete the new build and have surplus electricity to sell, we can expect it to push sales at the expense of Energy Efficiency and Demand-side Management.

Eskom's submission shows that Special Pricing Agreements are exempt from tariff hikes. We have a long standing objection to the extraordinary subsidy given to BHP Billiton (now South32).

Fuel costs: We note the widespread concern that Eskom's coal contracts are used to deliver a subsidy to coal miners. Despite burning less coal, Eskom paid more than MYPD3 allowed. Eskom says the low cost tied mines produced less than expected and it paid more than expected on short term contracts. It does not explain why or what prudent measures it took to ensure delivery according to contract or contain coal costs.

Nevertheless, its submission indicates the increasing economic hazard of depending on coal. We take it that Eskom will offer to return money in the next period following the present slump in coal prices. However, this merely turns the problem inside-out without resolving it since lower prices deter new mine development and so jeopardise future supplies. On the other hand, the 40 new mines which are said to be required will certainly result in serious destruction of the environment and of water in particular. The present drought should make the implications of further climate change clear. It is not clear however, that Eskom, the DoE and the DMR are capable of reading the lesson.

4. Tariff increase

Already in 2013, we documented[2] increasing numbers of people in electrified homes cutting their consumption of electricity and switching to other and mostly dirty energy sources such as coal, paraffin and burnable (often toxic) waste. Some households, particularly in more formal urban areas, have limited options for fuel switching. All households were struggling to pay their electricity bills and some were cut off altogether. And since the price of other energy sources also escalated, people struggled to pay for the alternatives.

[2] The groundWork Report 2013, *Talking Energy: Part one of the People's Power series*.

People said that energy was consuming ever more of their household budgets but that they couldn't live without it. Paying for it displaced other necessities including food. And many of those who could not pay their bill experienced very high levels of stress. Obviously those who are ill are most severely affected. The Department of Energy's household survey similarly found that the poorest 60% of people were spending a high proportion of their income on energy.[3]

In our observation, it is not just that the tariff hikes have put the squeeze on poor households. They are actually driving households into poverty.

At a community meeting in Austerville, Durban, called to discuss Eskom's reopener, these issues were reiterated.[4] People observed that the combination of loadshedding and high bills led to job losses, children not going to school, unhealthy eating and an increase in crime. Pensioners were particularly aggrieved as the electricity bill consumes a very large part of their income.

We note that free basic electricity is very unevenly applied across the country. It is supposed to be based on means testing but most municipalities do not have the capacity to do that. They either do it badly or use an arbitrary surrogate such as households with low consumption (150 kWh in eThekwini) or a 20 amp connection. It cannot be assumed that households with higher consumption or 60 amp connections are not poor. As we noted in our comment on Eskom's original MYPD3 application, the bottom 60% of households have just 11% of total household income: more than half the people are poor.

We reiterate our call for a universally applied inclining block tariff. It should start with a dramatically expanded free provision adequate to real needs for the first block. The first step to paid-for electricity should be shallow with increasingly steep steps thereafter including additional steps at the higher end. The total bill for profligate consumers should rise higher than the overall price rise.

5. Conclusion

Too much money is being asked to build the wrong thing and the bill is being sent to the wrong address. The escalation in tariffs results from decisions based on the interests of big industry and the bill rightly belongs with them. The majority of people cannot afford it and should not be asked to pay it.

[3] DoE, 2012. *A survey of energy-related behaviour and perceptions in South Africa: The Residential Sector household survey*, p.40ff

[4] Meeting at Austerville Community Hall on 14th May 2015.