Eskom

CONFIDENTIAL

Mr Chris Forlee
Chief Executive Officer
National Energy Regulator of South Africa
Kulawula House
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PRETORIA

Dear Mr Forlee

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

Introduction

The NERSA approval for Eskom to submit a one-year revenue application for the 2018/19 year refers. Due to the approval being made on 23 February 2017, Eskom will only be in a position to submit this revenue application by 1 June 2017. It is assumed that this will allow NERSA to undertake its analysis and public participation timeously.

Eskom wishes to bring to your attention that there are certain requirements in terms of the Multi-Year Price Determination (MYPD) Methodology, as published during October 2016 and the Minimum Information Requirement for Tariff Applications (MIRTA) that Eskom will not be able to meet for this application. Eskom humbly requests condonation for the MYPD methodology requirements that cannot be met and informs Nersa of the MIRTA guideline requirements that cannot be met.

MYPD Methodology requirements

With regards to the MYPD methodology, as published during October 2016, Eskom will not be in a position to meet the following requirements of the methodology applicable to a MYPD application. In terms of Section 4.5 of the MYPD methodology where "Any non-compliance with the procedure set out in this Methodology may be condoned by the Energy Regulator on application by Eskom", it is requested that the 2018/19 revenue application be made without meeting these requirements. It is motivated that not providing this required information has minimal impact on the achievement of the objectives of the Methodology; and is unlikely to prejudice to any stakeholder.

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Eskom wishes to clarify that with regards to the various primary energy related requests for condonation, Eskom had motivated these changes in its comments on the consultation paper and draft methodology as well as during the public hearing. With regards to the providing coal volumes burnt per station, per contract type and per supplier, it was 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. It needs to be pointed out that the condonation requests related to primary energy will be ongoing, until the methodology is revised. The requirements with regards to the regulatory asset base and research costs will be met in the next application cycle.

Table 1: MYPD methodology requirements that cannot be met

Section	MYPD Methodology requirement	Reason
9.2	Regulatory asset base (RAB) valuation	Eskom will not be in a position to undertake a RAB valuation for this application. The revised methodology was only finalised during October 2016. This does not afford Eskom sufficient time to undertake the valuation process. Eskom will use the last valuation (MYPD3) as the basis for the new application. This will provide a conservative valuation. The valuation process will be undertaken in time for the next revenue application.
11.4.3	Research costs: There must be proper governance procedures in place with industry input in terms of project selection and review.	Due to the methodology only being published during October 2016, Eskom was not in a position to include input from the industry in finalising the MYPD application. Any review and subsequent applications will include industry inputs.
12.2.4a	Coal volumes burnt per station, per contract type and per supplier.	It would not be possible to attribute burn costs and volumes to contract types and suppliers. The only option would be to make a theoretical assumption based on the ratio of purchases from contract types. However, it would be difficult to confirm the validity of the assumption.
12.2.5	The following coal handling costs per station shall be submitted with the MYPD application: building-up stockpiles, recovering from stockpiles, maintaining stockpiles, tons moved, kilometre travelled and payment rate.	Coal handling costs refers to costs associated with movement of coal within the power station. The costs associated with coal handling are not distinct per activity as proposed by NERSA cannot be easily ring-fenced or divided into the categories. In addition the activities listed do not constitute the bulk/normal day-to-day coal handling activities. It is thus proposed that coal handling costs be reported per power station.
12.8.1.1	Determine the costs per station for the water to be procured and highlight the amounts of water that will be designated for each process per plant	It would not be possible to determine water usage per process. Thus water usage per power station is proposed.
12.9.1 and 12.9.2	**Water treatment:** Eskom must determine the costs per station, particularly the cost of chemicals, electricity usage and labour. Eskom must demonstrate (in a detailed calculation per station, highlighting the costs mentioned above) how the costs were determined.	The water treatment costs are relatively small. Details on electricity usage and labour are not specifically determined. The cost of the water treatment chemicals and water quality is the main drivers of water treatment costs. Higher or lower rainfall, transfers between water schemes and systems, water quality, the actual mix of power stations in the production plan of a particular year and of course the quantity and cost of chemicals etc. are all factors that influence the cost/litre of water treatment.

Guideline on MIRTA

Eskom accepts that MIRTA is not prescriptive. It is a guideline providing direction to the licensee in compiling a revenue application. Eskom will endeavour to address the requirements as far as possible, but would like to highlight the few areas where this is not feasible. Key reasons for not meeting these requirements are aligned to the reason for a one year application, which include the uncertainty in the industry policy environment such as the review of independent resource plan, significant changes in the available capacity and uncertainty on the independent power purchase programme.

The requirement for changes in the Regulatory Reporting Manual (RRM) Volume 2, the Regulatory Financial Reporting (RFR) have been documented and discussed with NERSA over the MYPD 3 period. These changes are also mirrored in the MIRTA requirements. Thus the approach followed in the RFR, where revisions have been made, will be maintained in the MIRTA submission for this application. Eskom understands that NERSA is in the process of reviewing the various modules of the RRM and relevant changes will be made.

The requirements in terms of MIRTA that cannot be met and the reasons thereof are listed below.

Table 2: MIRTA Requirements that cannot be met

Section	MIRTA	Reason
2.1.3.1	Segmented Cash Flow Statement for the latest reporting period	NERSA has exempted Eskom from providing a Segmented Cash Flow, in its reporting requirements, as this is not feasible at a licensee level. The Eskom Group Cash Flow Statement will be provided.
2.1.3.2	**Financial information**: There seems to be a contradiction in the text as to years for which the projections need to be provided	Eskom to provide the following information: • Projections for years 4 and 5 of MYPD 3 • Application for 2018/19 Projections for years beyond the application cannot be provided. The reason for this is aligned to the reasons as approved by NERSA for a one year application for the 2018/19 year.
3.1.1.1	Asset by asset class	Eskom is not able to provide data per the asset classes as prescribed in the MIRTA templates. Asset classes will be provided as per the classes contained in Eskom information (e.g. Gx per technology etc.)
	Asset - Historic - Indexed Historic - Replacement cost	Historical assets will be based on Eskom historic asset base as reflected in AFS with slight deviation due to Avon and Dedisa being derecognised. The replacement asset base will be addressed under the MYPD methodology.
3.1.1.2	**Capital Expenditure** Overall summary of capital expenditure per asset class over the tariff period showing the actual capital spend; assets (work) under construction; assets transferred to commercial operation; abandoned; transferred to mothballed; At a minimum, a ten year forecast of the capital expenditure programme per asset class and per major project	Eskom 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. Information is provided per business category (e.g. strengthening, refurbishment in Distribution) and per project (e.g. Medupi, Kusile etc) and per technology (e.g. Nuclear, hydro etc.) Will not be in a position to provide ten year forecast per asset class – see reasons provided above; due to uncertainties will also not be able to forecast

3.1.1.3	**Asset disposals and impairments** List of assets disposed and/or decommissioned together with the reasons for such disposal and/or decommissioning	Eskom will not be in a position to provide details on each asset disposed etc.; assume it will only be for big ticket items
3.1.1.4	**Depreciation** The applicant must provide the following information, applicable to both historic and replacement cost basis: • Current depreciation amount included in the application; • Accumulated depreciation to date for the RAB by each of the asset classes and by electricity business, per division, where applicable;	See comments in 3.1.1.1 above
3.1.1.6	**Deferred Debits and Credits** The applicant must provide the following information: ▪ Detailing the origin of these balances; ▪ Amounts and period over which they will be released/charged to the Income Statement.	Currently the decision on the RCA is awaiting legal outcomes, so Eskom cannot predict the outcomes of the RCA balances as well as the liquidation thereof.
3.3	Sales Revenues and Demand Forecasts • Sales between regulated and non-regulated business; and • Sales volume in MWh for each of the above categories; • Projected sales to support the ten year forward-looking price path as per EPP	Eskom cannot provide sales volumes between regulated and non-regulated business and cannot provide sales volumes for some of the categories prescribed in the templates – e.g. Commercial per voltage, Industrial per voltage, Sports grounds, churches, water pumps etc. Due to uncertainty, projected sales to support the ten year price path will be a challenge.
3.4.3.2.1	**Coal Purchase and Burnt** • Aggregate coal purchases; volumes; price per ton; and costs per contract type; **Transport costs:** • To be reported as a separate line item for each coal contract type for each power station; • Provide a detailed explanation for any large and unexpected increases and strategies to control such increases; and • The strategies must go beyond the tariff period and the costs identified separately • Coal handling cost	Coal burn is not available per contract type. Coal cannot physically be separated into categories when it is burnt. The burn cost is calculated on a weighted average cost. Coal transportation costs (rail and road) for ST/MT purchases. Where coal is transported by conveyor (Cost Plus and Fixed Price), the conveyor cost is embedded in the coal cost, so it is not possible to separate it. Coal handling costs refers to costs associated with movement of coal within the power station. The costs associated with coal handling are not distinct per activity as proposed by NERSA cannot be easily ring-fenced or divided into the categories. In addition the activities listed do not constitute the bulk/normal day-to-day coal handling activities. It is thus proposed that coal handling costs be reported per power station.
4	**Environmental Levy** Costs and revenues must be separated from the regulated costs and revenues, i.e. the applicant must ring-fenced and itemise separately the costs and the revenues, depending on the treatment of the incidence of the levy on the applicant, associated with the levy.	Costs are fully ring fenced per Power Station per month. Revenue is not ring fenced. Cost for the levy is deemed to be similar in nature than any other Primary Energy or Operating cost and is therefore embedded in the total revenue recovery of Generation Division. Generation cannot report on ring fenced levy revenue at Generation level.

The table above highlights the key areas where the information required poses a challenge. This list is not meant to be exhaustive and it is possible that further challenges may be uncovered as Eskom delves into the details for the Revenue Requirement Application. As a result, Eskom would seek to try to meet the requirements of the guideline as far as is reasonably feasible.

Conclusion

It is submitted that despite the above, sufficient information will be provided to Nersa in order to undertake an analysis of the revenue application. I suggest that the NERSA and Eskom teams discuss how best to address the requirements over the short and longer term. Please contact Calib Cassim, General Manager (Financial Planning and Economic Regulation) if anything further is required.

Yours sincerely

Anoj Singh
CHIEF FINANCIAL OFFICER
Date: 28\08\17.