



ENERGY INTENSIVE USERS GROUP  
SOUTH AFRICA

**Press Release.**

January 28, 2010

**Comments on the NERSA consultation paper  
Eskom's Proposed MYPD (2)**

The Energy Intensive Users Group (EIUG) is an association of large energy intensive consumers. Membership of the association currently consists of 38 of the country's largest energy users, and these companies together consume approximately 40% of the total electricity sales in South Africa.

South Africans continue to be threatened by unplanned power cuts and the prospect of abnormally high electricity price increases. Higher economic growth is the necessary and essential requirement for achieving key national objectives including:

- Increasing employment;
- Poverty alleviation; and
- Raising the standard of living of all South Africans.

Economic growth is therefore the critical overriding goal and, in order to achieve this, it is necessary to have a sufficient, reliable and cost effective supply of electricity. A successful electricity generation, transmission and distribution infrastructure is central to achieving this.

An above inflation electricity price increase to give Eskom a long-term sustainable return on its capital invested is inevitable. However, Eskom's funding request of a 35% increase per year for the next three years poses a real economic threat, which will result in lower economic growth rates, lower employment growth and ultimately job losses.

This is unacceptable and, we believe, unnecessary in achieving the reliable and cost effective supply of electricity. In order to realise the above goal and objectives, we believe it is necessary that the following four key issues be urgently addressed:

Governance – Establish an effective integrated governance framework for the energy sector and Eskom specifically.

Pricing - Establish a realistic long term pricing structure based on economic and business principles.

Security of Supply - Establish and sustain acceptable levels of security, reliability and efficiency of electricity supply.

Competitiveness - Ensure that South Africa remains internationally competitive to maximise exports and minimise imports.

South Africa deserves and is entitled to, reliable and affordable electricity for all. As bulk consumers the EIUG members have a vital role in the economy in stimulating bulk electricity demand on a 24 hour a day basis, 7 days a week.

### **The NERSA Dichotomy**

- It is clear that the challenge facing NERSA is the trade off between a strong electricity sector and a strong economy
- The price increase needed to sustain Eskom supports neither of the above aspirations
- Eskom needs a cash injection and an improvement in its operating efficiency to support a strong economy
- No provision has been made for the cash injection and the increase in operational cost must be borne by the consumer
- Electricity is a production input cost to all in the economy and has a significant multiplier effect

### **The Integrated Resource Plan [IRP]**

The EIUG is very aware of the fact that the IRP in its present form is not adequate to enable NERSA to make a long term [beyond 3 year] cost determination

The EIUG would support considerable & urgent effort being allocated to this planning process to ensure that all South Africans and potential investors can plan and budget for their electricity requirement in a suitable planning cone to avoid resource availability restrictions and shocks to the system which do not encourage investment and job creation.

The IRP requires a funding model which would define how the income for feasibility studies, construction and operating costs, equity, debt and private sector investment; and the makeup of the energy and technology mix for the country is optimised to make best use of our limited skills and resources for the benefit of all South Africans.

### **ESKOM EFFICIENCY**

Last year at the Interim price increase hearings the EIUG and COM defined a number of areas where Eskom could improve on its operational efficiency, notably in the coal procurement arena.

It is recommended that Eskom be requested to deliver an improvement plan as part of these deliberations so that operating cost reductions can begin to materialise

### **ESKOM CASH INJECTION**

The proposal for Eskom to divest part of the Kusile project is a step in the right direction, however, the offer will have limited uptake due to the fact that construction risk has already been managed by Eskom and potential bidders cannot apply their expertise to enhance their capital return

The Kusile project risk is with Eskom and the South African consumer – not so some of the older established power stations with good track records where potential investors would be keen to show their skills – if the market became encouraging for them

### **THE KEY ELEMENTS OF THE EIUG SUBMISSION**

- ***The "country plan"***  
The development of a long term country plan [in the form of an IRP] is urgent and will present some short term options allowing for a more manageable roll out of the long term build program.

- ***Eskom funding***

The following estimates made by Eskom need to be challenged:

- Cost of capital
  - Source of funding
  - Asset values and valuation methodology
  - Weighted Average Cost of Capital (WACC)
- Depreciation
- Primary energy and operating costs
- Capital expenditure
  - Medupi and Kusile power stations are too expensive and late.
- Medium Term Supply and Demand Forecast

- ***Security of Supply***

The price reduction from 45% to 35% has been brought about by unrealistically reducing the forecast demand based on an aggressive DSM uptake

- However, past uptake has been low and the increased uptake is not supported by a change in DSM management
- Similarly the mass roll out of solar water heaters is both financially and operationally constrained.

- ***Limiting job losses***

It is imperative that there is adequate and affordable electricity capacity to promote economic growth and that our price leadership role in this arena is not lost.

- ***The long term price cone***

This needs to be reduced by:

- Reducing Eskom return on investment
- Managing and reducing the new build cost
- Alternate funding including sale of assets
- Accelerating the pace of IPPs
- Decreasing Eskom's operating expense inflation
- Bringing Eskom's operating efficiencies under control

- ***Non core issues***

Eskom has removed some expenditure on non-core assets however it is not clear that this responsibility has been accepted by counter parties [e.g. road maintenance]