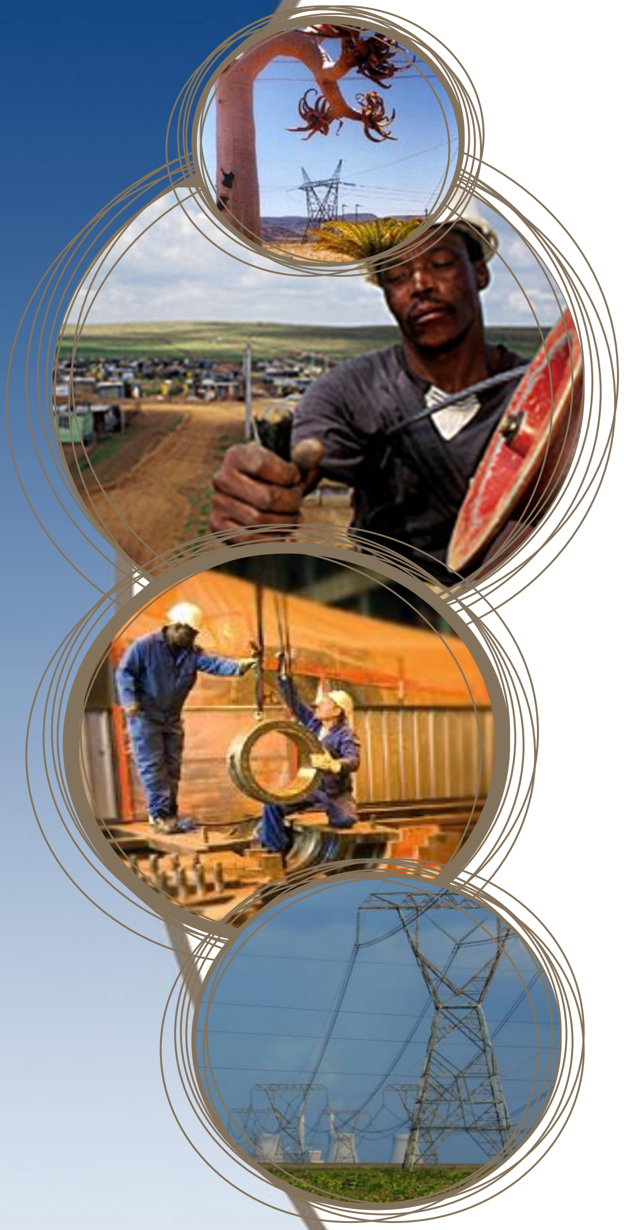


Briefing to the Select Committee on Public Enterprises and Communications on Eskom Unbundling Process

Date: 26 May 2021

Content

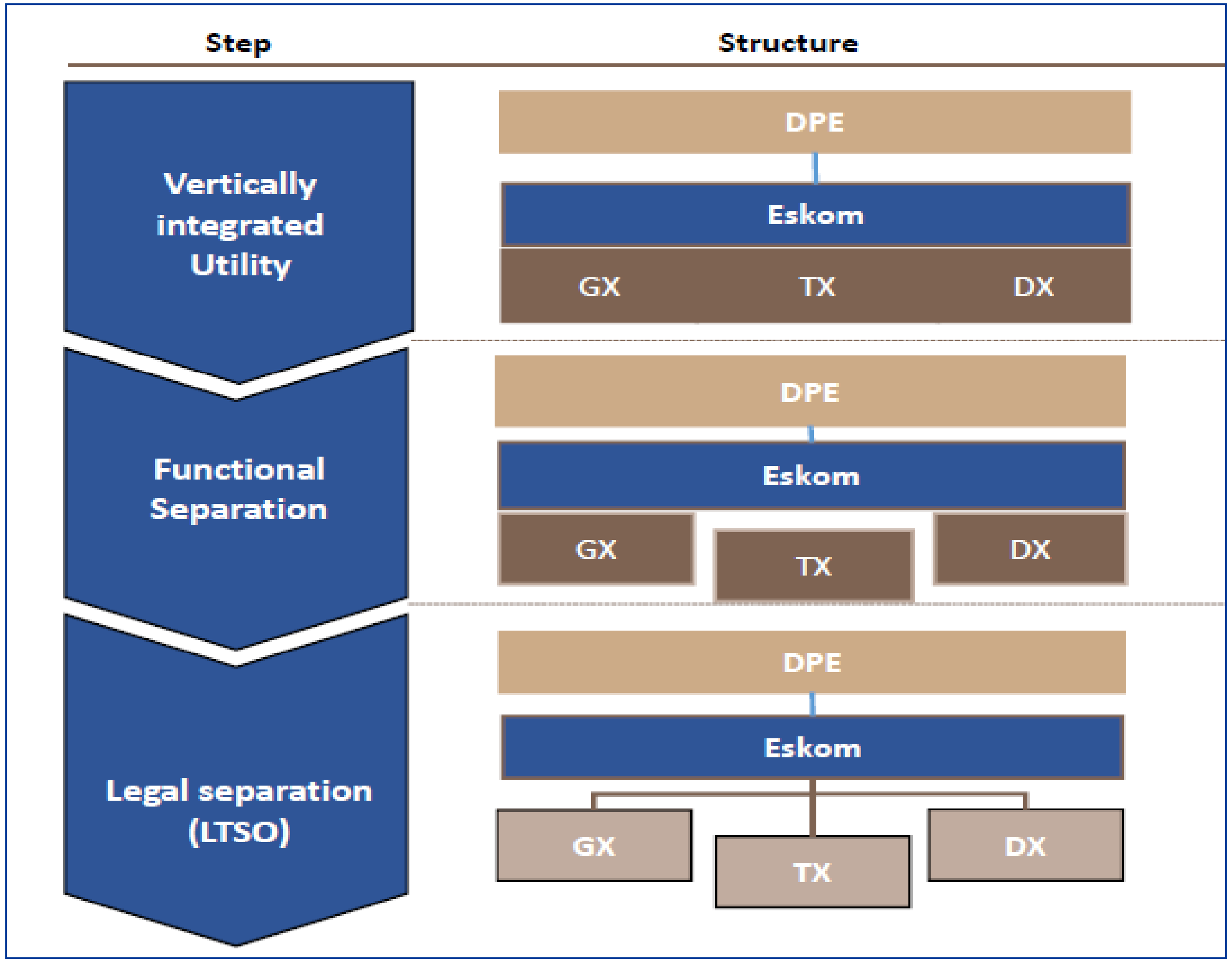
1 **Time lines for the unbundling**

2 Cost implications and where funding will come from

3 Impact this will have on service delivery to provinces

4 Implications of municipalities sourcing energy from IPPs on the unbundling process

High level Unbundling Roadmap – Starting with Transmission unbundling



Phase	High Level Roadmap Deliverables	Roadmap Timeline
1	**Divisionalisation and Relinking:** Establishment of divisional boards and heads appointed	Mar 2020
2	**Completion of “Functional Separation”** ▪ Transmission ▪ Generation & Distribution	 Mar 2021 Mar 2021
3	**Completion of “ Legal Separation”** ▪ Transmission ▪ Generation & Distribution	 Dec 2021 Dec 2022

Progress on Eskom unbundling – Functional Separation is complete and focus now is on Legal Separation of the TX entity

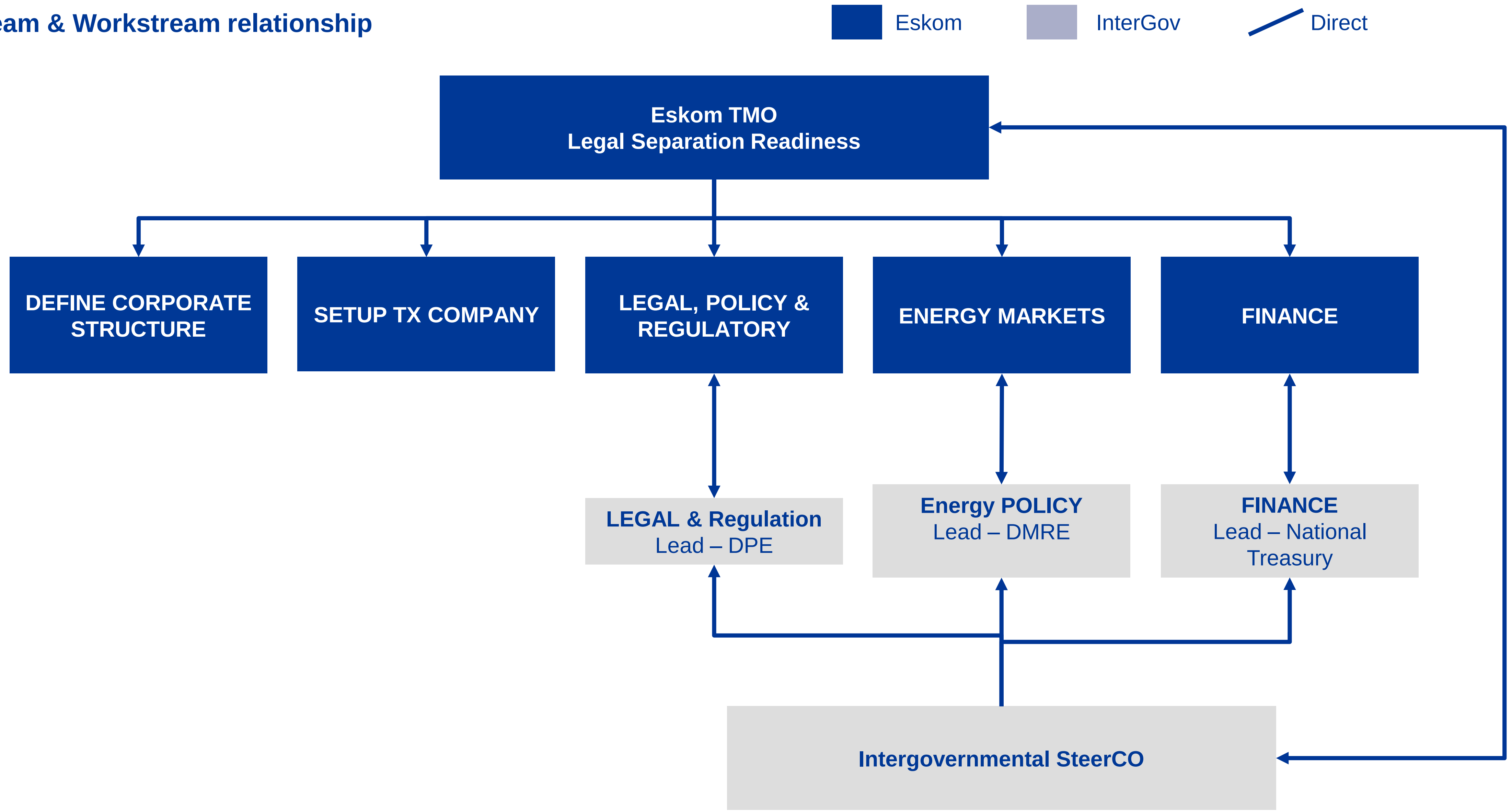
Current focus

Delayed | In Progress | Completed

	Legal Separation Program	Details of areas completed	Next steps	Status
FUNCTIONAL SEPARATION	Relinking	• ~8396 staff re-linked to the divisions • Cost centres and profit centres allocated	• Completed	Completed
	Divisionalisation	• Divisional MDs and Boards in place • Separate P&Ls in place through SAP • Transfer pricing implemented • Internal PPA and ESA in place	• Completed	Completed
	Operating Model Implementation	• Divisional DoA have been finalised and going through internal approval • N-1 and N-2 Organisation structures approved • Divisional org structure approved	• Completed	Completed
LEGAL SEPARATION	Legal Separation Readiness	• Intergovernmental Steering Committee and task teams in place • Due diligence on the Transmission business has been finalised • Corporate structure design has been finalised	• Integrated roadmap roadmaps and plans for the three workstreams to be finalised • Key decisions and approvals to be finalised • Government and DPE approvals and lender engagements • Organised Labour engagements	In Progress
	Legal Entity and Transfer of resources	• PFMA 1 application for the establishment of the Transmission Company has been approved	• Identification of the legislative, Regulative, licenses, Codes and methodologies that require amendment • PFMA 2 (Land & Rights) and PFMA 3 (Buildings, Plant & Equipment) to be submitted in due course • Organised Labour engagements	In Progress

Relationship between Eskom Task teams and InterGov workstreams to create an enabling environment

Task Team & Workstream relationship



10 areas of Government support are critical for the successful legal separation of Transmission

1. **Policy reform**
2. **Amendment of law**
   I. Access to land issue
   II. Creation of a new Holdings Company
3. **MoI amendment**
   I. Amendment of Eskom's MoI
   II. Creation of new TxCo MoI
4. **Defined process for new Tx License application required**
5. **Agreement / decision on Corporate Structure**
   I. Final End-state structure
   II. Interim Structure
6. **Liquidity and Solvency**
7. **Approvals from bondholders & financial instrument holders**
8. **Tariff unbundling and wholesale tariff required**
9. **Labour Engagements**
10. **Legal Due Diligence**

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Eskom Holdings SOC Ltd Cost Estimate – Legal Unbundling of Eskom

- The inception-to-date cost incurred is R2.7 million
- The high-level estimated cost is R500 million
- 42% is allocated to Information Technology and includes system changes, system configuration, transferring of data and implementation of new entities
- 26% is allocated for lender engagements, international and local, and changing of lender contracts if required
- 22% is required for establishment of entities, including changing of contracts, transferring of land and servitudes and changing of commercial contracts
- The remainder will be required for legal and audit support
- The above values excludes any internal costs and contingency

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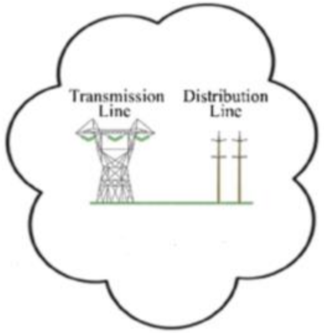
Impact this will have on service delivery to provinces



Functional Separation	National and Provincial service delivery risk
	The Distribution business **service delivery has not been negatively impacted** through functional separation.

Legal Separation	National and Provincial service delivery risk
	Service Delivery Impact Risk 1 – Continuity of provision of Retail Services (customer services, metering, billing, revenue collection, fault logging and management) to large industrial customers and municipalities directly connected to the Transmission grid currently managed by Distribution. **Proposed Mitigation -** Distribution to continue providing retail services to the Transmission connected customers via an SLA between Distribution and the Transmission businesses until the separate business units can become fully self-sufficient. **Service Delivery Impact Risk 2 -** Reliability and continuity of supply (fault restoration, time to reconnect, upgrades and new connections). Operations and maintenance of transmission and distribution interconnected networks could be impacted by the split responsibilities between the two company teams. **Proposed Mitigation -** Distributions operations and maintenance to continue having a close working and operational relationship with transmission operations in an unbundled Eskom to ensure continuity. Where appropriate this will be backed up by SLA.

Opportunities for the Distribution business in Legal Separation

Autonomy

As a standalone entity, Distribution will have greater autonomy in decision making improving the turnaround time and accountability for decisions

Decoupled risk profile

Majority of Eskom's debt burden will be decoupled from Distribution, improving it's balance sheet and risk profile for traditional financing institutions

In house functions and capabilities

Critical functions and processes such as procurement and talent management will be housed within the Distribution business which will significantly improve the efficiency of the business

Profitability

Distribution will be able to drive profitability though their agency to diversify and take strategic decisions around products and services to ensure the future profitability of the business

Investments and partnerships

Distribution will be more attractive for investment and have the agency to participate in partnerships as deemed necessary to ensure the sustainability of the business

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Municipalities sourcing energy from Independent Power Producers

Policy directions are moving away from the vertical integrated monopoly and single buyer model

Recent policy decisions:

DMRE Policy	Date	Description
Introduction of electricity regulations on new generation capacity	Amendment-16 October 2020	Allowing municipalities, as organs of state, **to procure new generation capacity** in accordance with the Integrated Resource Plan provided they do a feasibility study and follow the municipal systems act, municipal finance management act and the municipal public-private partnership regulations
Self-generating facilities license applications approvals	Announcement -30 October 2020	Approval that **NERSA may process license application** for self-generating facilities of above 1MW even if they are not in compliance with the Integrated Resource Plan (IRP 2019).
Legislation	**Date**	**Description**
Proposed Amendment to Electricity Regulation Act schedule 2	Announcement – at SONA	The **lifting of the licensing exemption threshold** for electricity generation from 1MW to 10 MW (50 MW)

Municipalities sourcing energy from Independent Power Producers
Impact on Eskom and the Transmission Subsidiary

Eskom

- **Introduction:**
  - The future transmission subsidiary and on Eskom Holdings **will be impacted by the policy to allow municipalities to buy from IPPs**. This impact is **increased by allowing other parties to contract directly with each other** – and the anticipated increase in self generation.
  - With or without the unbundling process, the **implication of the policy changes needs to be understood and mitigated**.
  - The impact on the Eskom unbundling process by allowing municipalities (and other customers) to purchase from IPPs **is therefore the requirement to change the current tariffs structure** and put in place an appropriate market system that will ensure the future sustainability of the subsidiary.
- **Impact is loss of revenue for Eskom and costs for customers:**
  - Eskom (in whatever corporate form) **will be losing revenue**. The revenue lost will include contribution to subsidies, legacy costs and the cost of keeping the system adequate and secure.
  - **The municipalities (and other customers) will be buying energy cheaper somewhere else** but relaying on Eskom for the foreseeable future to provide backup for when the IPP is not available.
  - The structure of the current Eskom tariffs allows the municipality (and other customers) **to avoid paying for these services, subsidies and legacy costs** for the energy they are procuring from the IPPS . The **remaining customers will have to pick up the tab** for the reliability as well as the subsidies and legacy costs.

The negative impact of allowing bi-lateral contracts will require proper frameworks to be in place to deal with wheeling charges that will avoid the problem of others taking advantage (free-loading) as well as a market system that will make participants responsible for their economic and technical decision and performance.

Municipalities sourcing energy from Independent Power Producers
Combining these policy decisions leads to industry reform

- These policy changes and the establishment of the TSO **should not be treated in isolation**; rather a **coherent market framework** must be put in place to facilitate this

  - The policy framework must **ensure a reliable and efficient electricity market**, that provides appropriate economic price signals while creating a level playing field for consumers and competing generators. **Specifically market participants should be encourage to take responsibility** for their physically positions and not enjoy economic benefits without obligations to the system.

- Specifically we need to address the following:

  - Balancing and Backup
  - **Tariff structure required to reform** to address recovery of unbundled network charges, fixed costs, subsidies and legacy costs

- In addition the framework should still maintain

  - **Grid Code compliance** requirements
  - **Compliance to connection** requirements