
NATIONAL ENERGY REGULATOR OF SOUTH AFRICA

In the matter regarding

THE EXTENSION OF THE NEGOTIATED PRICING AGREEMENT FOR POTLINES 1 AND 2 OF HILLSIDE ALUMINIUM SMELTER (PTY) LTD (“HILLSIDE SMELTER”) IN RICHARD’S BAY, UMHLATHUZE LOCAL MUNICIPALITY, KWAZULU-NATAL

By

ESKOM HOLDINGS SOC LIMITED (‘ESKOM’)

DECISION

Based on the available information and the analysis performed, the Energy Regulator decided as follows:

that the extension of the Negotiated Pricing Agreement for Potlines 1 and 2 of Hillside Aluminium Smelter (Pty) Ltd in Richard’s Bay, uMhlathuze Local Municipality, KwaZulu-Natal, be rejected and the reasons for the decision to reject, be approved

REASON FOR DECISION

1. BACKGROUND AND INTRODUCTION

- 1.1. Negotiated Pricing Agreements refer to any price agreement that may deviate from approved standard tariff levels, structures, service fees, network standards and capital contributions. NPAs have served and could potentially serve as a valuable instrument to support projects that require price certainty over many years.
- 1.2. The Hillside Aluminium Smelter is Eskom's largest industrial customer with an electricity consumption of ~10.3 TWh annually at a high load factor (>0.99, i.e. base load customer) and provides its total demand to the National System Operator (NSO) as interruptible reserve. The Hillside smelter is 100% owned by South32, is the only aluminium smelter in South Africa (SA) and accounts for approximately 5% of Eskom's total sales.
- 1.3. The Hillside Aluminium Smelter has a total electricity demand of 1 205MVA, which is supplied by Eskom through negotiated pricing agreements as well as at standard tariffs. The electricity supply at the Hillside Smelter is in the following ways:
 - i. Hillside potlines 1 and 2 NPA – 912 MVA;
 - ii. Hillside potline 3 NPA – 228 MVA; and
 - iii. Megaflex Agreement (apportioned between the potlines) – 65 MVA

2. THE PRINCIPLES OF THE NPA

- 2.1. The Electricity Pricing Policy (EPP) empowers NERSA to deviate from previously approved standard tariffs by way of NPA, the EPP (Policy Position 14(e)) stipulates that the Department of Mineral Resources and Energy (DMRE) must develop a transparent NPA application and approval process (i.e. framework) for setting out the criteria against which NERSA will evaluate, approve and monitor NPAs.

- 2.2. Therefore, NERSA has the mandate to treat all NPA applications in accordance with the approved processes and frameworks, as required by Policy Position 14(g)), of the EPP.

3. THE APPLICATION

- 3.1. On 14 December 2020, Eskom submitted an application requesting approval for the extension of the Hillside Smelter's potlines 1 and 2 of the existing 25-year NPA that expired on 31 July 2020, retrospectively from 1 August 2020. According to the application, the extension would terminate on the first of the calendar month following approval by NERSA of the proposed long-term 10-year NPA for the smelter's full power back.

4. LEGAL AND REGULATORY ANALYSIS IN REJECTING THE EXTENSION OF THE NPA FOR POTLINES 1 AND 2 OF THE HILLSIDE SMELTER

- 4.1. The premise from which regulation departs is the principle of legality. NERSA does not have the leverage of performing any function that it so deems necessary even though it is not sanctioned by law, the consequent thereto is invalidity of the action and/or judicial reviewability of the action on the basis of legality principle. The cardinal rule with regard to Eskom/Hillside Aluminium Smelter is that the tariff must be approved before implementation.
- 4.2. According to the application, Eskom's request for approval of a retrospective tariff charged was necessitated by intervening factors which if Eskom did not act in a manner that it did, there would be consequences to the economy, Eskom's revenue and labour market. These consequences would have resulted in job losses and a further negative impact on the economy, especially during the negative economic conditions that the country is facing and the devastating effects of the COVID-19 pandemic.
- 4.3. The action by Eskom resulted in the implementation of an unapproved tariff by NERSA, which is in violation of the ERA and its licence conditions. The hallmark of what Eskom has done traverses the regulatory requirement of tariff approval and from the context of the Electricity Regulation Act, 2006 (Act No. 4 of 2006) (ERA), it is non-compliance with the licence condition and ERA. The ERA provides for one remedy in the event of breach which is in section 18. The ERA does

not provide for retrospective approval to a conduct that happened in variance with it. NERSA has embarked on a separate process to deal with the violation of the ERA and licence conditions by Eskom.

- 4.4. The Energy Regulator can only consider and/or approve an NPA on receipt of an application that is based on applicable policy, therefore, the validity of the application is the date of the application.
- 4.5. The EPP empowers NERSA to deviate from approved licence tariffs by way of NPA, the EPP (Policy Position 14(e)) stipulates that the Department of Mineral Resources and Energy (DMRE) must develop a transparent NPA application and approval process (i.e. framework) for setting out the criteria against which NERSA will evaluate, approve and monitor NPA.
- 4.6. The interim framework for long-term NPAs that was approved by Department of Mineral Resources and Energy (DMRE) on 28 September 2020, does not provide for retrospective approval.
- 4.7. Eskom is requesting NERSA to approve the extension of potlines 1 and 2, retrospectively from 1 August 2020. NERSA is unable to consider the request to approve the extension retrospectively from 1 August 2020 because the decision of the Energy Regulator is effective from the date of approval, the retrospective request will not be supported by the Framework as the Framework was not gazetted with retrospective application. The Energy Regulator is unable to condone a conduct that does not fall within its purview and there is no law that empowers the Energy Regulator to act in that way.
- 4.8. Policy position 14(c) of the EPP states that all existing NPAs should be honoured until the end of their term and the customer would then purchase electricity either at standard tariffs or newly negotiated tariffs based on the latest framework. The EPP does not recognise extension of expired NPAs therefore the Energy Regulator cannot consider an application for extension.
- 4.9. According to the application submitted by Eskom, the Hillside Smelter may not be sustainable on the standard tariff, given that electricity is a major cost driver for Hillside Smelter's business. This may result in scaling down operations, leading to Hillside Smelter's business closing down.

- 4.10. Therefore, NERSA is unable to consider the request to approve the extension of NPA for potlines 1 and 2 for Hillside Smelter retrospectively from 1 August 2020. The reasons for the rejection are as follow:
- i. There is no applicable law that empowers the Energy Regulator to approve retrospectively;
 - ii. Energy Regulator decisions are effective from the date of approval;
 - iii. The EPP clearly states that all existing NPAs should be honoured until the end of contract and the customers would then purchase electricity either at standard tariffs or newly negotiated tariffs based on the latest framework. The EPP does not recognise retrospective extension of expired NPAs; and
 - iv. The approved interim long-term framework by DMRE also does not provide for retrospective approval.

5. THE APPLICANT

- 5.1. Eskom Holdings SOC Limited, registration number 2002/015527/06, is a Schedule 2 South African state-owned enterprise in terms of the Public Finance Management Act, 1999 (Act No. 1 of 1999) ('PFMA'), wholly owned by the South African Government. Eskom Holdings is regulated under licences granted by NERSA to generate, transmit and distribute electricity in terms of the ERA.
- 5.2. Eskom generates, transmits and distributes electricity to industrial, mining, commercial, agricultural and residential customers and other distributors. Eskom also buys electricity from and sells electricity to the countries of the Southern African Development Community (SADC).
- 5.3. Through its subsidiary, Eskom Enterprises (Pty) Limited, Eskom is also active in local unregulated markets and various African countries. These activities include the provision of electricity-related services to countries connected to the South African grid.

6. THE DECISION-MAKING PROCESS

- 6.1. On 21 August 2019, the National Regulator of South Africa (NERSA) received an application from Eskom Holdings (Pty) Ltd (Eskom)

requesting approval for a 10-year NPA with Hillside Aluminium Smelter in Richard's Bay, uMhlatuze Local Municipality, KwaZulu-Natal.

- 6.2. The EPP empowers NERSA to deviate from previously approved licence tariffs by way of NPA, the EPP (Policy Position 14(e)) stipulates that the Department of Mineral Resources and Energy (DMRE) must develop a transparent NPA application and approval process (i.e. framework) for setting out the criteria against which NERSA will evaluate, approve and monitor NPAs.
- 6.3. In the absence of an approved long-term framework by the DMRE, on 27 May 2020, NERSA made a decision to reject Eskom's application for a 10-year NPA with Hillside Aluminium Smelter.
- 6.4. NERSA also initiated a parallel process with the DMRE through the office of the Minister to expedite the finalisation of the enabling NPA framework. On 11 October 2019, a letter was sent to the Minister of Mineral Resources and Energy in this regard. On 14 February 2020 and 6 March 2020, workshops were held between NERSA, DMRE, Department of Public Enterprises (DPE), Eskom, National Treasury (NT) and Department of Trade and Industry (DTI), to discuss the development of a long-term framework, which was approved by the DMRE on 28 September 2020.
- 6.5. On 19 May 2020, NERSA received a letter from Eskom appraising NERSA of the proposed mechanism to ensure the continued provision of electricity on a negotiated price to Hillside Aluminium Smelter. Eskom was planning to implement an interim arrangement for potlines 1, 2 and 3 and change to the proposed new NPA contract price (of 21 August 2019), which would increase the tariff for all potlines. NERSA responded to the letter indicating that the tariff regulatory framework requires licensees to only charge tariffs that are either determined or in respect of agreements that are approved by NERSA.
- 6.6. On 7 October 2020, Eskom submitted another letter informing NERSA that it had decided to continue to apply the current pricing provision that expired on 31 July 2020, for Hillside Aluminium Smelter's potlines 1 and 2 from 1 August 2020, until NERSA approves the 10-year NPA, which Eskom submitted in December 2020 and final application resubmitted on 19 February 2021.

- 6.7. On 2 November 2020, a meeting was held between NERSA and Eskom to discuss the implementation of an illegal tariff, which is in violation of its licence conditions. The outcome of the meeting was that Eskom must submit two applications. The first application was for a 10-year NPA application that would be assessed based on the interim long-term framework approved by the Minister of Mineral Resources and Energy. Eskom was further advised to explore whether the Ekurhuleni Metro//NCP special tariff judgement could be of assistance to their challenges and that after evaluation of the judgement, Eskom may bring a special tariff application to NERSA for consideration.

7. ESKOM'S NON-COMPLIANCE WITH THE LICENCE CONDITIONS

- 7.1. Eskom is charging the Hillside Smelter a tariff that is not approved by the Energy Regulator and not supported by Electricity Regulation Act, 2006 (Act No. 4 of 2006) (ERA). NERSA had identified an issue of non-compliance with the licence conditions and ERA. NERSA is undertaking a separate regulatory process to address the non-compliance and violation of licence conditions.

8. APPLICABLE LAW

- 8.1 The legal basis for the decision of the Energy Regulator to approve electricity prices is derived from the Electricity Regulation Act, 2006 (Act No. 4 of 2006) and the National Energy Regulator Act, 2004 (Act No.40 of 2004) ('the National Energy Regulator Act'). The procedure to be followed in deciding the price is derived from the Promotion of Administrative Justice Act, 2000 (Act No.3 of 2000) ('PAJA').

9. CONFIDENTIALITY

- 9.1. There are no confidentiality issues.

10. RECOMMENDATION

- 10.1. From a conspectus of the facts, reasons and evidence presented to the Energy Regulator, it is appropriate to reject the extension of NPA for potlines 1 and 2 for Hillside Smelter retrospectively from 1 August 2020 for the following reasons:

- 10.1.1 There is no applicable law that empowers the Energy Regulator to approve retrospectively;
- 10.1.2 Energy Regulator decisions are effective from the date of approval;
- 10.1.3 The EPP clearly states that all existing NPAs should be honored until the end of contract and the customers would then purchase electricity either at standard tariffs or newly negotiated tariffs based on the latest framework. The EPP does not recognise retrospective extension of expired NPAs; and
- 10.1.4 The approved interim long-term framework by DMRE also does not provide for retrospective approval.

End.