



Eskom Holding SOC Ltd's Board of Directors

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Eskom Holdings SOC Limited
Per email: govendt@eskom.co.za

7 August 2018

Dear Sirs

COAL BASELOAD INDEPENDENT POWER PRODUCERS – STATUS OF THE POWER PURCHASE AGREEMENTS

1. We write to you on behalf of the [Life After Coal/Impilo Ngaphandle Kwamalahle Campaign](https://lifeaftercoal.org.za/) (made up of the Centre for Environmental Rights (CER), groundWork, and Earthlife Africa ("Earthlife"),¹ with regard to the two preferred bidders under the coal baseload independent power producer (IPP) procurement programme: Thabametsi Power Company (Pty) Ltd's proposed Thabametsi coal-fired power station, and ACWA Power Khanyisa Thermal Power Station RF (Pty) Ltd's proposed Khanyisa coal-fired power station ("the coal IPPs").
2. We refer to our previous letters to Eskom of 1 February 2018 and of 8 June 2018,² as well as to our meeting with Mr Mabuza, Mr Govender, Ms Rambharos, and Ms Zingitwa on 29 June 2018.
3. In our correspondence and at the 29 June meeting, we recorded, *inter alia*, our concerns regarding the coal IPPs; including those addressed by the findings of a report by the Energy Research Centre ("ERC report") of May 2018.³
4. We now write to request further information in relation to the coal IPPs; in particular to ascertain at what stage Eskom is in relation to the signing of the power purchase agreements (PPAs) for the coal IPPs.

¹ Website available at <https://lifeaftercoal.org.za/>.

² Our letter of 1 February 2018 is available here https://cer.org.za/wp-content/uploads/2018/02/LAC-Letter-to-Eskom-1-Feb-2018_final.pdf and our letter of 8 June 2018 is available <https://cer.org.za/wp-content/uploads/2018/06/LAC-letter-to-Eskom-re-ERC-report-8-June-2018.pdf>.

³ The ERC report has been sent to you and is available here <https://cer.org.za/wp-content/uploads/2018/05/ERC-Coal-IPP-Study-Report-Finalv2-290518.pdf>. We can also make it available again on request.

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Legal Requirements for the signing of PPAs

5. We point out that, despite statements⁴ from the Minister and Department of Energy (DoE) regarding the anticipated signing of the PPAs for the coal IPPs, the projects are unable to reach commercial close – according to the Request for Qualification and Proposals for New Generation Capacity under the Coal Baseload IPP Procurement Programme (RFP) – in that they do not have all the licences required, and because there are High Court review proceedings pending⁵ against the environmental authorisations for both Thabametsi and Khanyisa.⁶ We also record our instructions to challenge the granting of any other licences to these projects.
6. In relation to the legal requirements for the signing of a PPA, regulation 9 of the 2011 Electricity Regulations on New Generation Capacity GN R399 (GG 34262) (the “New Generation Regulations”), published under the Electricity Regulation Act, 2006 (ERA) states, *inter alia*, that:

“(1) A power purchase agreement between the buyer and an IPP must meet the following requirements –
(a) value for money;
(b) appropriate technical, operational and financial risk transfer to the generator;
(c) effective mechanisms for implementation, management, enforcement and monitoring of the power purchase agreement; and
(d) satisfactory due diligence in respect of the buyer's representative and the proposed generator in relation to matters of their respective competence and capacity to enter into the power purchase agreement.

*(2) Before the buyer concludes a power purchase agreement, the buyer or the procurer **must**, subject to any approvals required in terms of the PFMA (Public Finance Management Act, 1999) –*
(a) ensure that the power purchase agreement meets the requirements set out in sub-regulation (1);
(b) ensure that the buyer has a contract management plan that explains the capacity of the buyer, and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the power purchase agreement and any other agreements relating to a new generation capacity project to which the buyer is a party, to National Treasury and the Minister on a regular basis; and
(c) put in place arrangements to ensure that any portion of the buyer's allowable revenue approved or allocated by the Regulator for purposes of implementation of new generation capacity projects will be used solely for the purpose of ensuring that the buyer's financial obligations in respect of new generation capacity projects will be met” (emphasis added).

7. The Public Finance Management Act, 1999 (PFMA) also sets out numerous obligations and requirements relevant to the signing of a PPA, including:

- 7.1. Section 50(1), states that the accounting authority for a public entity (in this instance, Eskom’s board) “*must— (a) exercise the **duty of utmost care** to ensure reasonable protection of the assets and records of the public entity; (b) act with fidelity, honesty, integrity and **in the best interests of the public entity in***

⁴ See <http://www.energy.gov.za/files/media/speeches/2018/Speech-by-Minster-Radebe-at-the-Stakeholder-Engagement-in-Gallagher-Estate-01June2018.pdf> and <http://www.energy.gov.za/files/media/pr/2018/MediaStatement-on-the-Independent-Power-Producer-Programmes-08032018.pdf>.

⁵ The Thabametsi case court papers can be accessed here <https://cer.org.za/programmes/pollution-climate-change/litigation/the-proposed-thabametsi-ipp-earthlife-africa-johannesburg-v-department-of-environmental-affairs-thabametsi-power-project-pty-ltd-and-others> and the Khanyisa court papers can be accessed here <https://cer.org.za/programmes/pollution-climate-change/litigation/groundwork-acwa-power>.

⁶ According to the RFP, in order to reach commercial and financial close, a preferred bidder must: provide, at least one month before commercial close, a number of authorisations and records including an environmental authorisation, waste management licence (WML), water use licence (WUL), atmospheric emission licence (AEL), and a licence to generate electricity from NERSA; and prove to the DoE’s satisfaction that all High Court review proceedings of the decisions to grant any environmental consents required for (the project) have been satisfactorily resolved. P99, 14.2, Part A, RFP.

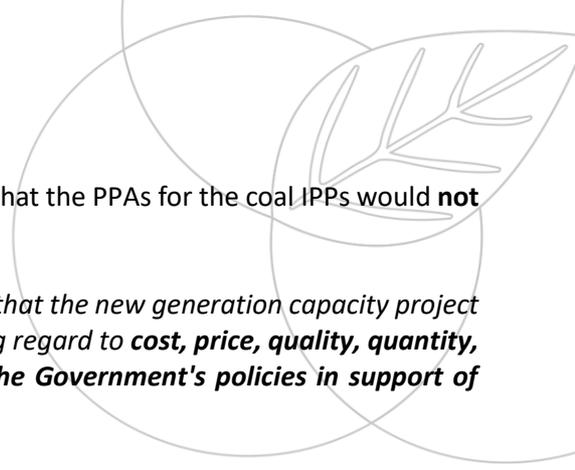
managing the financial affairs of the public entity; ... and (d) seek, within the sphere of influence of that accounting authority, to prevent any prejudice to the financial interests of the state” (emphasis added).

- 7.2. According to section 51(2) *“If an accounting authority is unable to comply with any of the responsibilities determined for an accounting authority in this Part, the accounting authority must promptly report the inability, together with reasons, to the relevant executive authority and treasury” (emphasis added).*
- 7.3. Section 54(2) states that *“Before a public entity concludes any of the following transactions, the accounting authority for the public entity must promptly and in writing inform the relevant treasury of the transaction and submit relevant particulars of the transaction to its executive authority for approval of the transaction ... (b) participation in a significant partnership, trust, unincorporated joint venture or similar arrangement ... (e) commencement or cessation of a significant business activity...” (emphasis added).*
- 7.4. Section 66 places restrictions on borrowing, guarantees and other commitments, and section 70, which deals with guarantees, indemnities, and securities by Cabinet members, states that *“[a] Cabinet member, with the written concurrence of the Minister (given either specifically in each case or generally with regard to a category of cases and subject to any conditions approved by the Minister), may issue a guarantee, indemnity or security which binds - ... a national public entity referred to in section 66(3)(c) in respect of a financial commitment incurred or to be incurred by that public entity.”*
8. It is clear that there are various steps that need to be taken by Eskom in accordance with the New Generation Regulations and the PFMA, **before** the PPAs for the coal IPPs can be signed – in addition to the requirements that need to be met by the coal IPPs as preferred bidders in terms of the RFP, as set out above.
9. In a presentation to Parliament by the Minister of 6 March 2018 (the “IPP presentation”),⁷ attached as **annexure A**, it appears from slide 19 of the presentation that the only outstanding “procurement compliance issues” for the coal IPPs are (or were, as at that date) 4 regulatory approvals and risk management steps, namely *“the section 54 approval by DPE (Department of Public Enterprises) authorizing Eskom to enter into PPA”; “PFMA: Section 66 and 70 Approvals by Minister of Finance”; “Government Support Framework Agreement (GSFA) Schedules”; and “Nersa IPP Licence Approval (PPA and price) - Responsibility of individual”*. We note that:
 - 9.1. no reference is made to the other requirements that must be met in order for these projects to reach commercial close such as the issuing of various licences (including atmospheric emission licences and water use licences), or the resolution of pending litigation challenging the environmental consents for the projects;
 - 9.2. it is not clear from the IPP presentation whether the “value for money” assessment in terms of regulation 9(1)(a) read with 9(2)(a) has been conducted; and
 - 9.3. as this presentation was made in March 2018, it is not clear whether the outstanding steps listed on slide 19 have subsequently been taken, or what the current status is in relation to the PPA processes for the coal IPPs.

Value for money assessment

10. **We request confirmation as to whether the “value for money assessment”, required by regulation 9(1)(a), read with 9(2)(a) of the New Generation Regulations, has been conducted by Eskom or the DoE.** If an assessment has been conducted, we request details of when this assessment was undertaken, whether it was conducted by Eskom or the DoE, and a copy of the decision that was reached.

⁷ Available at https://sawea.org.za/wp-content/uploads/2018/04/Presentation-to-PCE-on-IPP_06-March-2018.pdf.

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11. Whether or not the assessment has already been conducted, we submit that the PPAs for the coal IPPs would **not** be value for money, for the reasons set out below.
 12. The New Generation Regulations define “value for money” as requiring “*that the new generation capacity project results in a net benefit to the prospective buyer or to Government having regard to cost, price, quality, quantity, risk transfer or a combination thereof, but also where applicable to the Government's policies in support of renewable energy*” (emphasis added).
 13. The RFP states that the “*outcome of the consideration as to whether or not a project delivers value for money, is required to produce an assessment that the project is in the best interests of and delivers an acceptable outcome to the buyer (Eskom) and the Government acting on behalf of and in the best interests of the people of South Africa, including electricity users*” (emphasis added).⁸
 14. In our June 2018 letter to Eskom,⁹ in which we referred to the report by the ERC,¹⁰ which looks at the impacts of proceeding with the coal IPPs, from an economic and climate change perspective, we explained that the inclusion of the coal IPPs in South Africa’s electricity build plan would significantly raise the total system costs compared to a scenario without the coal IPPs. Similarly, in all scenarios, the coal IPPs would significantly increase greenhouse gas (GHG) emissions. We pointed out that, from an economic, environmental, human health, and climate perspective, the commissioning of these projects is a bad decision, which will continue to be met with significant opposition from civil society, including the Life After Coal Campaign.
 15. We now also refer to a new report, entitled “Water Impacts and Externalities of Coal Power”,¹¹ which looks at the broad range of water impacts and externalities linked to the coal sector, which are currently not accounted for in electricity planning. It confirms, *inter alia*, that water for power generation in South Africa is under-valued, and that mining and burning coal impacts significantly on our scarce water resources.
 16. We submit that the coal IPPs would **not** meet the “value for money” requirement as defined in the New Generation Regulations because:
 - 16.1. they would not provide a net benefit to Eskom or government, and would certainly not meet the criteria of the definition of “value for money” in the New Generation Regulations; and
 - 16.2. they would not be in the best interests of Eskom or government, or in the best interests of the people of South Africa as required by the RFP.
 17. We base this conclusion on the following:
 - 17.1. South Africa currently has – and for some time has had – surplus base supply capacity and, according to the ERC report, **does not need new base supply capacity** for the foreseeable future.¹² Where new capacity is required, this can be supplied more cheaply and flexibly, and with fewer harmful impacts, from sources other than coal. In other words, even if and when additional capacity might be required, coal is not the best or least-cost source to provide it, and it certainly is not the preferred source from a climate, environmental, and human health or well-being perspective.
 - 17.2. The coal IPPs are likely to cost South Africa an **additional 19.6 billion Rand** compared with a least-cost electricity system.¹³

⁸ P59, 6.1.8.2, Part A, RFP.

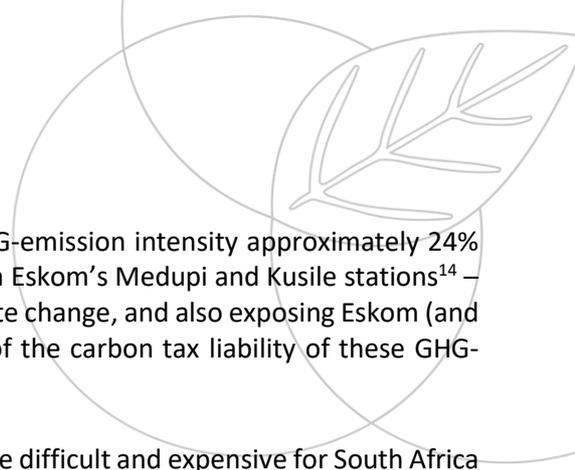
⁹ Available at https://cer.org.za/wp-content/uploads/2018/06/LAC-letter-to-Eskom-re-ERC-report_-8-June-2018.pdf.

¹⁰ Available at <https://cer.org.za/wp-content/uploads/2018/05/ERC-Coal-IPP-Study-Report-Finalv2-290518.pdf>.

¹¹ Available at https://cer.org.za/wp-content/uploads/2018/07/Water-Impacts-and-Externalities-Report_LAC.pdf.

¹² P12, ERC report.

¹³ P37, ERC report.

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- 17.3. The coal IPPs will emit **excessive volumes of GHGs** – with a GHG-emission intensity approximately 24% higher than the current Eskom fleet average and 58% higher than Eskom’s Medupi and Kusile stations¹⁴ – exposing the country and the world to increased impacts of climate change, and also exposing Eskom (and ultimately consumers) to higher costs of electricity as a result of the carbon tax liability of these GHG-intensive emitters.
- 17.4. Because of the high GHG emissions, the coal IPPs will make it more difficult and expensive for South Africa to meet its international commitments under the Paris Agreement. GHG emissions elsewhere in the electricity sector and in other, much-more-expensive sectors would have to be curtailed so that the coal IPPs could operate for their anticipated lifespans. The ERC report finds that in a climate change mitigation policy scenario that aims to comply with our Paris commitments and meet the low peak plateau decline (PPD) trajectory required to avoid the worst impacts of climate change, Kusile power station will be stranded by 2050.¹⁵ The ERC report also states that, even without the coal IPPs, *“to meet the low-PPD budget with current technology options already requires that the existing coal plants are run at lower load factors to 2050, i.e. there is stranded capacity in the sector.”*¹⁶ Either the coal IPPs, or Eskom’s ‘newer’ coal-fired power stations, or all, are likely to become stranded assets, if South Africa is to take the necessary steps to mitigate and address the impacts of climate change, in accordance with both international and national legal obligations.
- 17.5. Although the high costs incurred by Eskom in purchasing electricity from the coal IPPs will be “pass-through” costs to consumers, and can be recovered by Eskom through prices, charges, and tariffs - according to regulation 10 of the New Generation Regulations, the costs of the expensive coal IPP electricity, the carbon tax, and any additional costs of having to close Eskom power stations early, or run them at lower load factors as a result of the coal IPP offtake requirements, will **inevitably lead to inordinately-expensive and unaffordable electricity for the people of South Africa**. This will mean more defection from the grid by consumers and businesses, reduced electricity usage, and, ultimately, reduced electricity sales as electricity becomes unaffordable. This will have devastating effects for business and individuals; particularly those who cannot afford to defect from the grid. Therefore, even though the coal IPPs costs are a “pass through”, it is unlikely that Eskom and government will be able to **fully** recover these costs, if their effect is to render electricity so expensive that it is unaffordable. In any event, this will certainly not benefit the economy or the people of South Africa.
- 17.6. According to the ERC report, the coal IPPs will result in *“increasing pressure on Eskom”*, as *“[b]uilding new coal plants in a situation of low demand means reducing the output of Eskom’s fleet, potentially accelerating the ‘utility death spiral’ in which Eskom already finds itself and putting the electricity supply industry – and thus the South African economy – at risk”*.¹⁷ Government and the people of South Africa will have to bear the brunt of this problem.
- 17.7. In addition, there are the external costs of coal-fired power; these being the costs that will result from the air and water pollution and climate change impacts that will be caused by the coal IPPs. There is credible evidence to show the high costs of coal-fired power on our water, air, and climate.¹⁸ These significant costs are currently being disregarded, and borne by those impacted and/or the state. There is also a growing body of case law internationally, in which those affected are seeking to claim the costs of these

¹⁴ P10, ERC report.

¹⁵ P30, ERC report.

¹⁶ P30, ERC report.

¹⁷ P8, ERC report.

¹⁸ See, for example, Holland “Health impacts of coal fired power plants in South Africa” at <https://lifeaftercoal.org.za/wp-content/uploads/2017/04/Annexure-A4.pdf>; https://cer.org.za/wp-content/uploads/2018/07/Water-Impacts-and-Externalities-Brochure_LAC.pdf and <http://carbonmajors.org/>.

damages from the polluting companies, governments, and the banks that have financed them. There is every reason to believe that similar cases will be brought in South Africa.

17.8. Contradictory figures for estimated jobs during construction and operation have been provided for both IPPs. A DoE fact sheet¹⁹ estimates 5 163 jobs during construction, and 9 183 during operation for Thabametsi, whereas Thabametsi's NERSA generation licence application cites 2400 jobs during construction and 182 during operation. For Khanyisa, the DoE fact sheet cites 1 450 jobs during construction and 4 341 during operation, while the Khanyisa's NERSA generation licence application states 1 500 jobs during construction and 150 during operation. The figures provided by the DoE appear to be inflated and – although represented as “job years” - do not coincide with the figures provided by the IPP companies themselves in the NERSA licence applications.²⁰ In any event, when considering jobs, consideration must also be given to the job potential of renewable energy electricity sources as an alternative to the intended new coal capacity, as well as the job opportunities involved in the required decommissioning and rehabilitation processes for coal-fired power stations and mines. If the coal IPPs are built, this will displace and delay the deployment of new renewable capacity and its many opportunities (particularly for reskilling of labour) for a number of years; when, in fact, urgent steps need to be taken to facilitate a just transition to a low-carbon economy. Consideration also needs to be given to the fact that many businesses will suffer and jobs will be lost as a result of the inordinately-expensive electricity from the coal IPPs, and stranding of generation assets as a result of the coal IPPs.

18. In the circumstances, we strongly dispute that the coal IPPs could be regarded as value for money.

PFMA obligations

19. Eskom's board has fiduciary duties (under section 50 of the PFMA) to exercise the duty of utmost care to ensure reasonable protection of the assets and records of Eskom and to act in the best interests of Eskom. The board is also obliged to seek to prevent any prejudice to the financial interests of the state. We submit that the signing of the PPAs, would constitute a breach of those duties, particularly given the outstanding licences and approvals and the fact that the coal IPPs do not satisfy the requirements of regulation 9(1), read with 9(2), of the New Generation Regulations.

20. We submit that Eskom is therefore obliged to refuse to enter into the PPAs for the coal IPPs.

21. Insofar as Eskom asserts that it does not have a choice as to whether to sign the PPAs, but is still of the view that the signing of the PPAs would be harmful to Eskom's interests, the implication is that the board is unable to comply with its fiduciary duties and responsibilities. As such it is the board's obligation – under section 51(2) of the PFMA - to “promptly report the inability, together with reasons, to the relevant executive authority and treasury”.

Outstanding necessary information

22. Given the public interest in the coal IPPs, as a result of: the high additional costs to the South African public; the extremely high climate impacts; and the negative environmental impacts that would result from these coal IPP projects, it is crucial that stakeholders be timeously updated on the status of and steps being taken in relation to the coal IPPs.

¹⁹ The Fact Sheet is available at <https://www.esi-africa.com/wp-content/uploads/2016/10/Coal-IPP-factsheet.pdf>.

²⁰ A recent July 2018 briefing paper by Meridian Economics, entitled “An overview of the employment implications of the South African power sector transition” demonstrates, inter alia, that misunderstanding of job numbers is due in part to the use of nonstandard employment metrics and categorisation methodologies, poor and inconsistent disclosure of study parameters, and uncertainty about future energy sector development paths. The paper confirms that these aspects can and should be addressed. See https://sawea.org.za/wp-content/uploads/2018/07/Employment-implications-SA-power-sector-transition_Meridian-final4layout.pdf.

23. We hereby request:

23.1. further and additional information on:

- 23.1.1. the status of the procurement process for each of the coal IPPs, to the extent this is within Eskom's knowledge;
- 23.1.2. what steps still need to be taken before commercial and financial close are reached and before the PPAs are to be signed; what each step entails; and when these steps are envisaged to be taken; and
- 23.1.3. what steps have already been taken in addition to and subsequent to those listed in slide 19 of the IPP presentation (annexure A to this letter);

23.2. confirmation whether the assessment in regulation 9(2)(a) of the New Generation Regulations has already been conducted in relation to either or both of the coal IPPs, and whether a decision has already been made as to whether either or both of the coal IPPs are value for money;

23.3. if the regulation 9(2)(a) requirements **have already been considered**, that you advise:

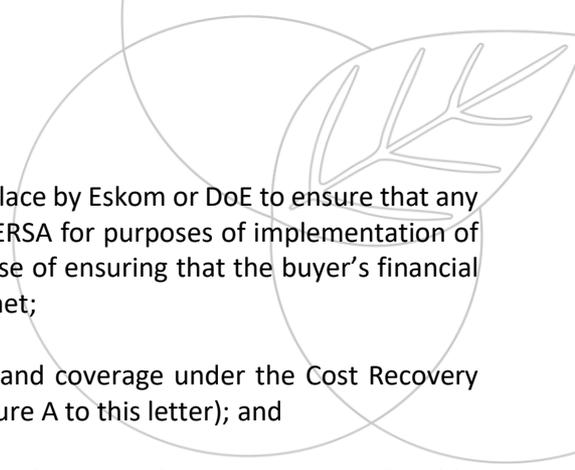
- 23.3.1. which requirements have been met, if any, and which have not;
- 23.3.2. whether Eskom or the DoE made the decision/s;
- 23.3.3. if any decision/s (in respect of either or both) of the coal IPPs have been taken and a copy of any such decision;

23.4. if the 9(2)(a) requirements have **not yet been considered**, that you:

- 23.4.1. advise what the next steps are – who will be responsible for considering the requirements, and by when; and
- 23.4.2. **notify** us when any decisions under regulation 9(1)(a) and 9(2) have been made; and advise us as per paragraph 23.3 above.

24. We also request that you provide us with copies of the following (if they exist):

- 24.1. records of the consideration of the “technical, operational and financial risk transfer to the generator”, in terms of regulation 9(1)(b) of the New Generation Regulations and as referred to in slide 19 of the IPP presentation referred to above (annexure A to this letter);
- 24.2. the “mechanisms” for implementation, management, enforcement and monitoring of each of the PPAs, as required by regulation 9(1)(c) of the New Generation Regulations;
- 24.3. the “due diligence” in relation to matters of competence and capacity to enter into the PPA, in terms of regulation 9(1)(d) of the New Generation Regulations;
- 24.4. the contract management plan in terms of regulation 9(2)(b), that explains the capacity of the buyer (Eskom), and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor, and report on the PPA and any other agreements relating to a new generation capacity project to which the buyer is a party, to National Treasury and the Minister on a regular basis;

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- 24.5. details of any arrangements (in terms of regulation 9(2)(b)) put in place by Eskom or DoE to ensure that any portion of Eskom's allowable revenue approved or allocated by NERSA for purposes of implementation of new generation capacity projects will be used solely for the purpose of ensuring that the buyer's financial obligations in respect of new generation capacity projects will be met;
- 24.6. the "cost recovery – NERSA letter to Eskom approving signature and coverage under the Cost Recovery Mechanism" referred to on slide 19 of the IPP presentation (annexure A to this letter); and
- 24.7. the "Government Support Framework Agreement" entered into by DoE, the Department of Public Enterprises (DPE), National Treasury (NT) and Eskom, referred to on slide 19 of the IPP presentation (annexure A to this letter).
25. We trust you will have no objections to making the requested information available, particularly given the public interest in being informed and updated on the coal IPPs, given the impacts that they will have.
26. Please contact us, should you have any questions.
27. We await your response as soon as possible and by no later than **7 September 2018**.

Yours faithfully

CENTRE FOR ENVIRONMENTAL RIGHTS

per: 

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