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## NATIONAL ENERGY REGULATOR OF SOUTH AFRICA

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In the matter regarding an

**Application for a three-year Negotiated Pricing Agreement (NPA) with ArcelorMittal South Africa (AMSA) Saldanha Works in the Western Cape**

By

**ESKOM HOLDINGS SOC LIMITED (ESKOM)**

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### THE DECISION

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Based on the available information, public comments and the analysis performed on Eskom's three-year incentive pricing package application, the National Energy Regulator of South Africa (NERSA), at the meeting held on 30 August 2022, decided as follows:

1. The special pricing agreement between Eskom Holdings SOC Limited and AMSA Saldanha Works in the Western Cape be approved.
2. The approval of the negotiated pricing agreement is for the power demand of 225 MVA, at consumption of 700 GWh/annum.
3. The special pricing agreement will run for a maximum of three years and commence no later than six calendar months following the month of NERSA approval.
4. Eskom will charge a special tariff of [REDACTED]. The proposed NPA tariff rate will be escalated annually on 1 April by SA PPI + [REDACTED] for the duration of the agreement.
5. AMSA Saldanha Works will provide interruptibility to the National System Operator for utilisation when the system is constrained.

6. AMSA Saldanha Works must consume, or its forecast annual consumption must be a minimum of 80GWh and/or the load factor must be equal to or greater than 60 per cent.
7. Eskom must submit progress reports on its NPA with AMSA Saldanha Works six months after the effective date and thereafter every six months until the end of the special pricing agreement to enable NERSA to monitor the implementation of the agreement.
8. Any changes in law will result in the NPA re-opener whereby both parties agree and apply to the Regulator an alternative approach that result in NPA complying to the legislations.

**End.**

# Contents

1. LEGAL MANDATE .....	8
2. BACKGROUND AND INTRODUCTION.....	8
3. THE APPLICATION .....	9
4. THE APPLICANT .....	10
5. THE DECISION-MAKING PROCESS .....	10
6. LIST OF STAKEHOLDERS WHO COMMENTED ON THE CONSULTATION PAPER	10
7. ANALYSIS OF THE APPLICATION .....	10
7.1 Applicable Guiding Principles .....	10
7.2 Parameters Used for the Analysis.....	11
7.3 Alignment to the EPP.....	11
7.4 AMSA Saldanha Works' Net Contribution to the Economy .....	12
7.5 Tariff Structure Analysis.....	14
7.6 NPA Contract Duration .....	19
7.7 Technical Benefits of AMSA Saldanha Works NPA.....	19
7.8 AMSA Saldanha Works Electricity Consumption.....	20
7.9 Impact on Other End-Users.....	21
7.10 Economic Impact Analysis.....	24
7.11 Risk Assessment .....	26
8. CONFIDENTIALITY .....	28
9. CONCLUSION AND RECOMMENDATION .....	28
10. ANNEXURE 1: SUMMARY OF STAKEHOLDER COMMENTS .....	29

**List of Tables**

Table 1: EPP Policy Position 14 ..... 11  
Table 2: AMSA Saldanha Works' net contribution to the economy ..... 13  
Table 3: Marginal contribution to fixed costs ..... 15  
Table 4: Average NPA pricing model ..... 16  
Table 5: Marginal contribution to fixed costs ..... 18  
Table 6: Impact of implementation of NPA..... 23  
Table 7: Risk assessment..... 26

## List of Figures

Figure 1: Graphical demonstration of contribution to fixed costs .....	18
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## ABBREVIATIONS

AFSA	Aluminium Federation of South Africa
CAPEX	Capital Expenditure
CPI	Consumer Price Index
DMRE	Department of Mineral Resources and Energy
DPE	Department of Public Enterprises
dtic	Department of Trade, Industry and Competition
EAF	Energy Availability Factor
ERA	Electricity Regulation Act, 2006 (Act No. 4 of 2006)
EPP	Electricity Pricing Policy
EIUG	Energy Intensive Users Group of Southern Africa
ESI	Electricity Supply Industry
FDI	Foreign Direct Investment
ILT	Interim Long Term
IPP	Independent Power Producer
NERA	National Energy Regulator Act, 2004 (Act No. 40 of 2004)
NERSA	National Energy Regulator of South Africa
NPA	Negotiated Pricing Agreement
MYPD	Multi-Year Price Determination
MVA	Megavolt Ampere
NSO	National System Operator
OCGT	Open Cycle Gas Turbine
PAJA	Promotion of Administration Justice Act, 2000 (Act No. 3 of 2000)
PFMA	Public Finance Management Act, 1999 (Act No. 1 of 1999)
PPI	Producer Price Index
RBIDZ	Richards Bay Industrial Development Zone Company
REIPP	Renewable Power Independent Power Producer
ROI	Return on Investment
SAAIR	South African Aluminium Industry Roadmap of 2017
SADC	Southern African Development Community (SADC)
STF	Short-Term Framework
TWh	Terawatt-hour

## **1. LEGAL MANDATE**

- 1.1** Section 4(c) of the National Energy Regulator Act, 2004 (Act No. 40 of 2004) (NERA) mandates the National Energy Regulator of South Africa (NERSA) with the responsibility to undertake the functions detailed in section 4 of the Electricity Regulation Act, 2006 (Act No. 4 of 2006) ('the ERA').
- 1.2** In performing its mandated functions, NERSA is required to ensure that:
- i. the efficient, effective, sustainable and orderly development and operation of electricity supply infrastructure in South Africa;
  - ii. the interests and needs of present and future electricity customers and end users are safeguarded and met, having regard to the governance, efficiency, effectiveness and long-term sustainability of the electricity supply industry within the broader context of economic energy regulation in the Republic;
  - iii. investment in the electricity supply industry is facilitated;
  - iv. universal access to electricity is facilitated;
  - v. the use of diverse energy sources and energy efficiency is promoted;
  - vi. competitiveness and customer and end-user choice are promoted; and
  - vii. a fair balance between the interests of customers and end users, licensees, investors in the electricity supply industry and the public is facilitated.
- 1.3** The Electricity Pricing Policy (EPP) empowers NERSA to deviate from previously approved standard tariffs by way of negotiated pricing agreements (NPAs). 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.
- 1.4** The amended framework for short-term NPAs was approved by the DMRE on 20 August 2020.
- 1.5** Therefore, NERSA has the mandate to treat all NPA applications according to the approved processes and frameworks, as required by Policy Position 14(g) of the EPP.

## **2. BACKGROUND AND INTRODUCTION**

- 2.1** Negotiated pricing agreements refer to any price agreement that may deviate from the 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.

- 2.2** AMSA is part of the ArcelorMittal Group, has five operating plants in South Africa and competes globally and supplies steel locally and for exports. AMSA Saldanha Works is one of the five operations and is situated in Saldanha Bay in the Western Cape. AMSA Saldanha Works has been under care and maintenance since April 2020. AMSA has approached Transnet, Eskom, the Western Cape Government and the Saldanha Bay Municipality for assistance with the restart of the Saldanha Works operations converting from the costly iron ore/coke steelmaking to an electric scrap-melting model.
- 2.3** AMSA Saldanha Works' beneficiation will be from 100% South African materials from scrap metal and will be the only producer in South Africa (SA) of ultra-thin, high strength steel products (flat sheet and hot-roll coil [HRC]).
- 2.4** The proposed NPA aims to facilitate the restart of AMSA Saldanha Works, which has been under care and maintenance since April 2020. This will restore base sales to Eskom of 700 GWh/annum (225 MVA) and provide an NPA revenue of approximately █████ billion over the three-year period. The proposed NPA will also assist AMSA Saldanha Works in being globally cost-competitive, specifically versus East Asian steel products, while addressing the change in its business model to electrical scrap melting.
- 2.5** AMSA Saldanha Works will be a baseload customer of Eskom with a load factor projected to reach approximately █████ at full ramp-up.

### **3. THE APPLICATION**

- 3.1** On 1 December 2021, Eskom submitted an application for a three-year NPA with AMSA Saldanha Works, in line with the amended short-term framework for NPAs approved by the Minister of Mineral Resources and Energy on 20 August 2020.
- 3.2** NERSA conducted a preliminary assessment of the three-year NPA application to ensure that the application is compliant with the amended framework for short-term NPAs. Findings of the preliminary assessment were that the three-year NPA application is compliant with the amended framework for short-term NPAs.

## **4. THE APPLICANT**

- 4.1** 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.
- 4.2** 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 Southern African Development Community (SADC) countries.
- 4.3** Through its subsidiary, Eskom Enterprises (Pty) Limited, Eskom is also active in local unregulated markets and various African countries. These activities include providing electricity-related services to countries connected to the South African grid.

## **5. THE DECISION-MAKING PROCESS**

- 5.1** On 18 February 2022, NERSA published Eskom's application for a three-year NPA with AMSA Saldanha Works, a consultation paper and an invitation to stakeholders to submit written comments on the NERSA website. The closing date for comments was 5 April 2022.
- 5.2** The Energy Regulator plans to make its determination on Eskom's application for a three-year NPA with AMSA Saldanha Works on 30 August 2022.

## **6. LIST OF STAKEHOLDERS WHO COMMENTED ON THE CONSULTATION PAPER**

- 6.1** Written stakeholder comments were only received from Eskom and have been analysed and discussed in Annexure 1.

## **7. ANALYSIS OF THE APPLICATION**

### **7.1 Applicable Guiding Principles**

- 7.1.1** In analysing the application, NERSA was guided by the parameters outlined in the amended framework developed and approved by the Minister of

Mineral Resources and Energy, and in line with the requirements of the EPP, Policy Position 14(f).

## 7.2 Parameters Used for the Analysis

- 7.2.1 The following parameters were assessed in analysing the application:
- i. Alignment to the EPP
  - ii. Net Contribution of AMSA Saldanha Works to the economy
  - iii. Tariff Structure Analysis
  - iv. Technical Benefits of the AMSA Saldanha Works NPA Agreement
  - v. AMSA Saldanha Works Electricity Consumption
  - vi. Impact on other Users
  - vii. Economic Impact Analysis
  - viii. Risk Assessment.

## 7.3 Alignment to the EPP

- 7.3.1 Eskom’s application for a three-year NPA with AMSA Saldanha Works has been assessed against Policy Position 14 of the EPP, which guides the evaluation and approval process of the short-term NPAs. The NPA application aligns with Policy Position 14 of the EPP, as follows:

**Table 1: EPP Policy Position 14**

<b><i>EPP Requirements</i></b>	<b><i>NERSA Analysis</i></b>
<i>a) NPAs are permitted, but must be structured in a way so as to minimise price distortions.</i>	<i>The NPA has been structured in such a way that the proposed pricing agreement would serve to minimise under-recovery to Eskom. The implementation of the NPA would result in AMSA Saldanha Works contributing to Eskom’s fixed costs, therefore minimising price increases for other customers. Non-NPA customers will be worse off without this proposed NPA and the positive contribution to fixed costs.</i>
<i>b) Commodity price risk exposure must be hedged outside of the ESI.</i>	<i>The proposed pricing arrangement is ZAR denominated and does not have any commodity-linked pricing components and, therefore, no linkage to commodity risk.</i>
<i>c) Existing NPAs will be honoured until the end of the contract.</i>	<i>Both Eskom and AMSA Saldanha Works would be contractually obliged to honour the proposed NPA, once approved and subsequently implemented, subject to the hardship clause.</i>

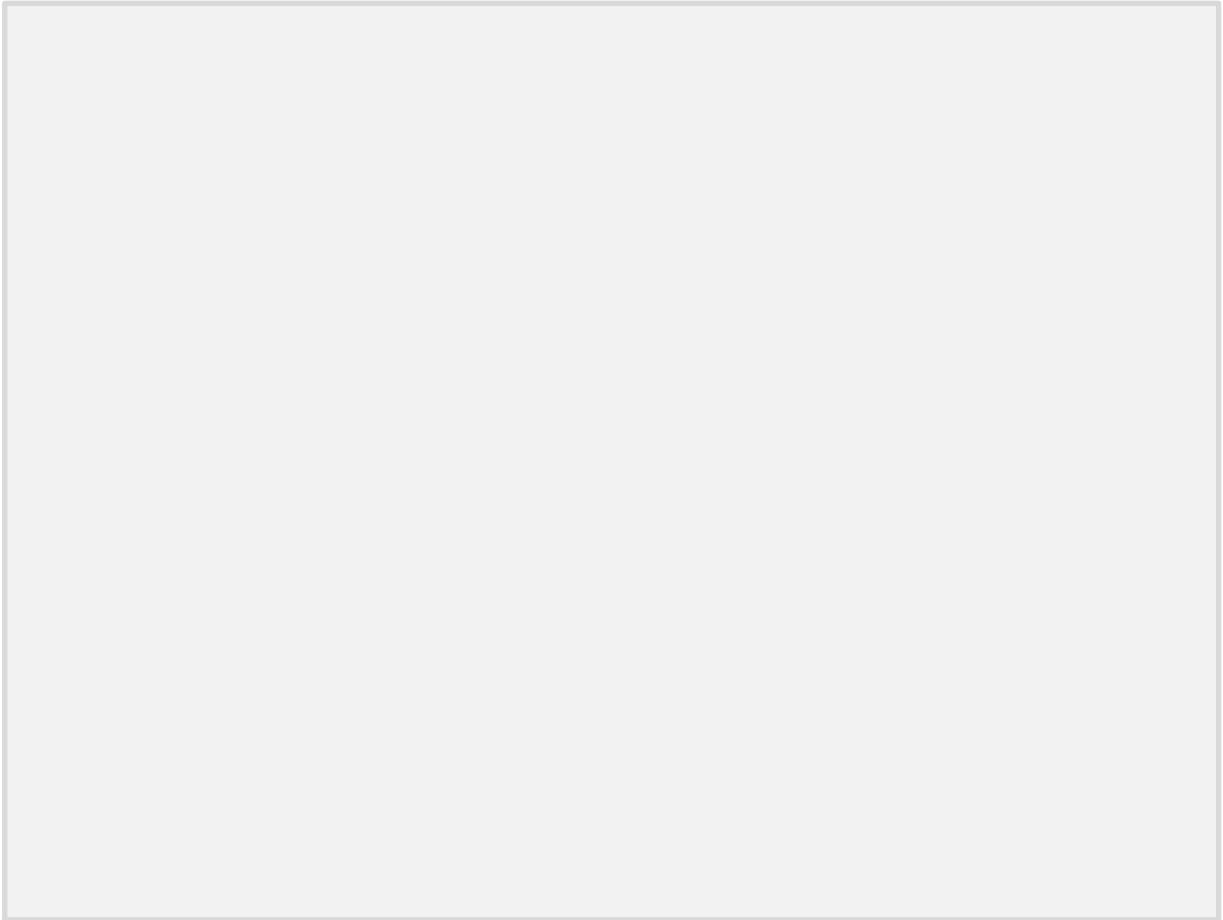
<p>d) <i>The evaluation of NPAs at inception must be based on the cost of supply (excluding cross-subsidies) on a discounted cash flow basis over the period of the agreement.</i></p>	<p><i>The cost of supply for NPAs intended for the sale and consumption of electricity in South Africa must be defined by the electricity price forecast, which will be based on the prevailing regulatory methodologies in South Africa, inclusive of an appropriate risk premium.</i></p>
<p>e) <i>The DMRE must develop a transparent NPA application and approval process to ensure adequate evaluation and consultation with key stakeholders, including National Treasury.</i></p>	<p><i>An amended framework for short-term NPAs was developed by the DMRE and has been used as a basis for analysing the application. The DMRE consulted with various stakeholders (such as the dtic, NERSA, DPE and Eskom), including the National Treasury, in the development of the amended short-term negotiated pricing agreement framework. NERSA also followed due regulatory public consultation process on the AMSA Saldanha Works NPA application.</i></p>
<p>f) <i>The DMRE must update the NPA pricing framework setting out the evaluation criteria. NERSA will approve and monitor NPAs in accordance with the framework.</i></p>	<p><i>The DMRE developed an amended short-term framework, which was approved on 20 August 2020. In assessing AMSA Saldanha Works NPA application, NERSA used the parameters set out in the amended framework for short-term NPAs and was satisfied that the considerations and analysis are ripe for submission to the Energy Regulator. Therefore, NERSA will approve and monitor NPAs in accordance with the amended framework for short-term NPAs.</i></p>
<p>g) <i>All applications must be treated in accordance with the approved processes and frameworks and be approved by NERSA.</i></p>	<p><i>The EPP uses a peremptory clause obligating NERSA to ensure that the consideration of any NPA must be in terms of the framework. This provision eliminates the prospects of exercising discretion on the side of the Energy Regulator. Management can confirm that due regulatory processes and the amended framework for short-term NPAs were followed by NERSA when assessing AMSA Saldanha Works NPA application.</i></p>

7.3.2 The AMSA Saldanha Works NPA is also compliant with the amended framework for short-term NPAs.

#### **7.4 AMSA Saldanha Works' Net Contribution to the Economy**

7.4.1 Table 2 below illustrates the value of the steel industry in South Africa, as produced by AMSA Saldanha Works.

**Table 2: AMSA Saldanha Works' net contribution to the economy**



- 7.4.2 Table 2 above shows that the proposed price by AMSA will result in [REDACTED] revenue to Eskom, given the 700 GWh/consumption at a 60% load factor. The cost to generate these revenues amount to [REDACTED], given the consumption plus transmission losses, which is below the proposed revenue. The difference between the revenue and the costs will result in a net contribution by AMSA to Eskom's revenue of [REDACTED].
- 7.4.3 Given the value of imported finished goods scrap, exported finished goods scrap, salaries, taxes and the value of exported finished goods scrap, the total steel value chain in SA amounts to approximately [REDACTED] per annum, as shown in Table 2 above.
- 7.4.4 The downstream production amounts to 600 tons that would be realised in the South African economy due to the existence of AMSA. The total Rand value of the downstream production is [REDACTED], and the total contribution

made by AMSA to the economy is [REDACTED], as shown in Table 2 above. Therefore, AMSA's contribution, combined with the downstream production, will amount to [REDACTED].

- 7.4.5 At AMSA Saldanha Works there are currently 13 direct employees and 5 indirect contract employees with it being in care and maintenance. With closure the other previous employees/contractors were 'let go'. The reopening will result in 260 people being employed by AMSA and another 375 direct permanents on site contractors (refractory furnace builders, ladle repairs, maintenance services, cleaning services, fuels and lubricants etc.).

## **7.5 Tariff Structure Analysis**

- 7.5.1 This section deals with the approach that has been adopted in the analysis of the proposed tariff structure. This, conducted in conjunction with the applicable framework, will include determining the rationale of providing an NPA to the customer, the present and projected revenue and operating cost assumptions, the escalation factor and the assessment of price distortions.

### *The applicable framework*

- 7.5.2 The Framework for Short-Term Negotiated Pricing Agreements issued by the DMRE was developed to facilitate the provision of incentive pricing, to enable qualifying consumers to sustain and/or increase their use of electrical energy to support sustained and increasing economic activity in South Africa.

- 7.5.3 The framework requires that the financial assessment of the reference base incentive price for an NPA be measured against the annual MYPD figures as determined by NERSA, amongst other factors. According to the Electricity Pricing Policy (EPP), 'NPAs need to be evaluated against the appropriate price projections on a discounted basis over the life of the project. Factors that should be taken into consideration include period, TOU, location, voltage level and risks.'

### *The rationale for providing an NPA to customer*

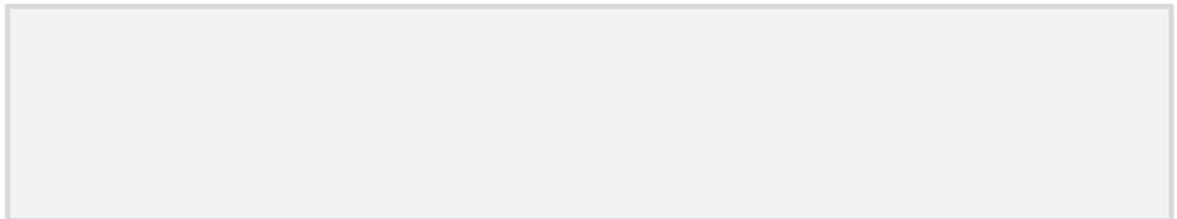
- 7.5.4 The rationale for providing an NPA to a customer is to ensure that the variable costs of supply are recovered, and any revenue surplus should contribute to the fixed costs. In the absence of the NPA, this contribution to fixed costs would not be realised. Instead, it would have to be absorbed by other customers, resulting in higher future standard tariff increases for them, i.e. higher than the impact of the NPA. This is demonstrated and quantified in section 7.9 below.

- 7.5.5 The incentive price level should include an appropriate risk premium and be as high as reasonably possible in consideration of the applicant's cost recovery and ultimate sustainability.
- 7.5.6 An energy loss factor of [REDACTED] is added to the costs, which is a make-up of a [REDACTED] loss relating to Transmission and [REDACTED] to Distribution-related losses. The revenue is based on the proposed minimum average rate of [REDACTED] at consumption of 700 GWh/annum.
- 7.5.7 The proposed NPA tariff rates will be escalated annually, effective on 1 April each year following the base year for the duration of the agreement. However, in ArcelorMittal's case, a mix of escalation principles is proposed as follows:
- (a) The Active Energy Rates of the NPA would escalate by the SA PPI + [REDACTED] (based on the change in the year-on-year Stats SA PPI ratio).
  - (b) The rates of other fixed and variable charges components of the NPA will escalate at the MegaFlex Tariff escalation rate as approved by NERSA.

*Marginal contribution to fixed costs*

- 7.5.8 Table 3 below shows revenue, cost of supply and marginal contribution to fixed costs. The assumption is that implementation would be from 1 July 2022.

**Table 3: Marginal contribution to fixed costs**

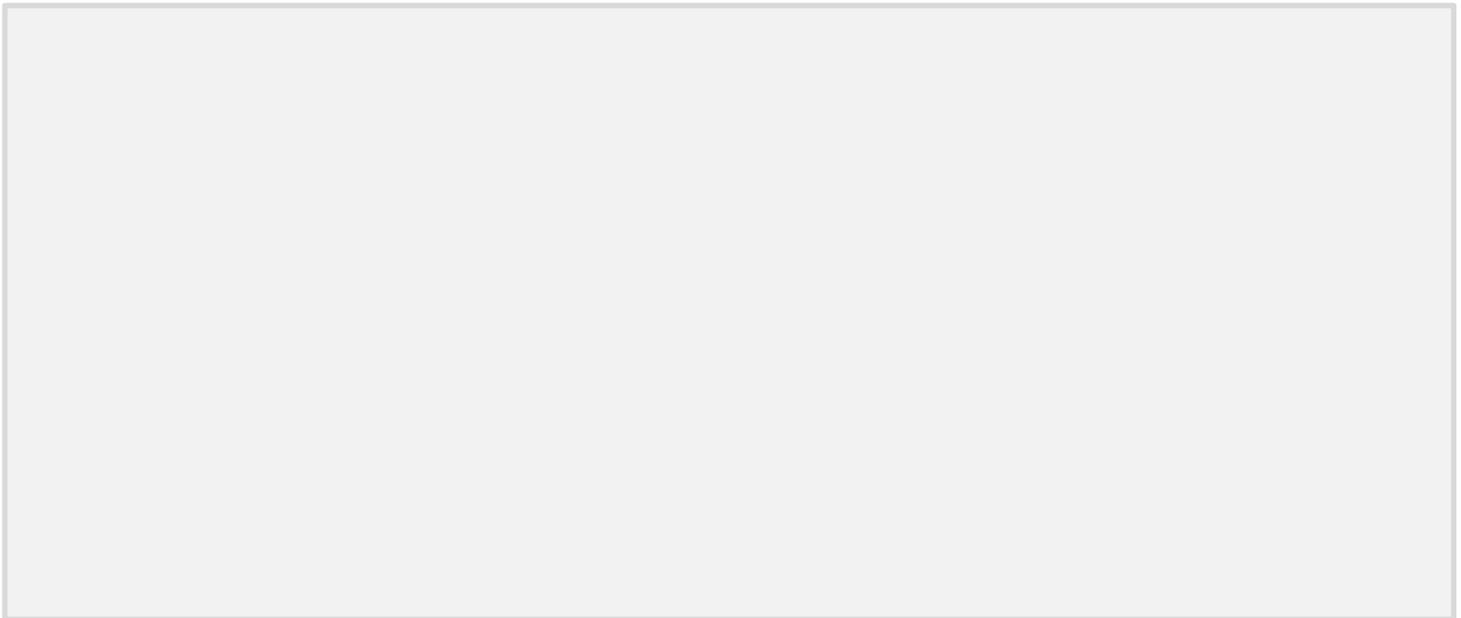


Source: AMSA application

*Average NPA price*

- 7.5.9 Table 4 below calculates the annual average price that Eskom will be charging to ArcelorMittal for the 36 months of the NPA. The proposed revenues exceed the cost of supply over the full duration of the NPA, which is acceptable.

**Table 4: Average NPA pricing model**



Source: AMSA pricing model

*Gross profit sharing arrangement*

7.5.10 A gross profit sharing incentive, limited to the rebate provided against MegaFlex tariff, shall be included as a proxy to commodity price uplift. This will ensure that the impact on other customers, through the incentive pricing plan, is minimised should ArcelorMittal perform better financially than forecasted. In this instance, ArcelorMittal will equally share with Eskom, on an annual basis, any [REDACTED].

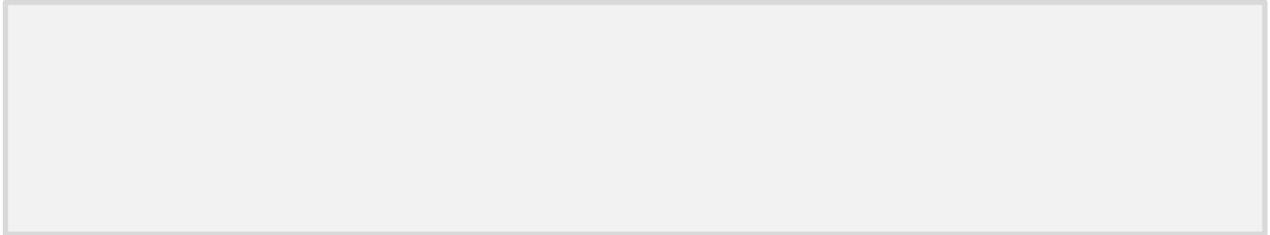
*NERSA analysis*

7.5.11 In applying the DMRE-approved short-term NPA framework, NERSA will be compliant with the requirement of Policy Position 14 of the EPP of 2008, which prescribes as follows:

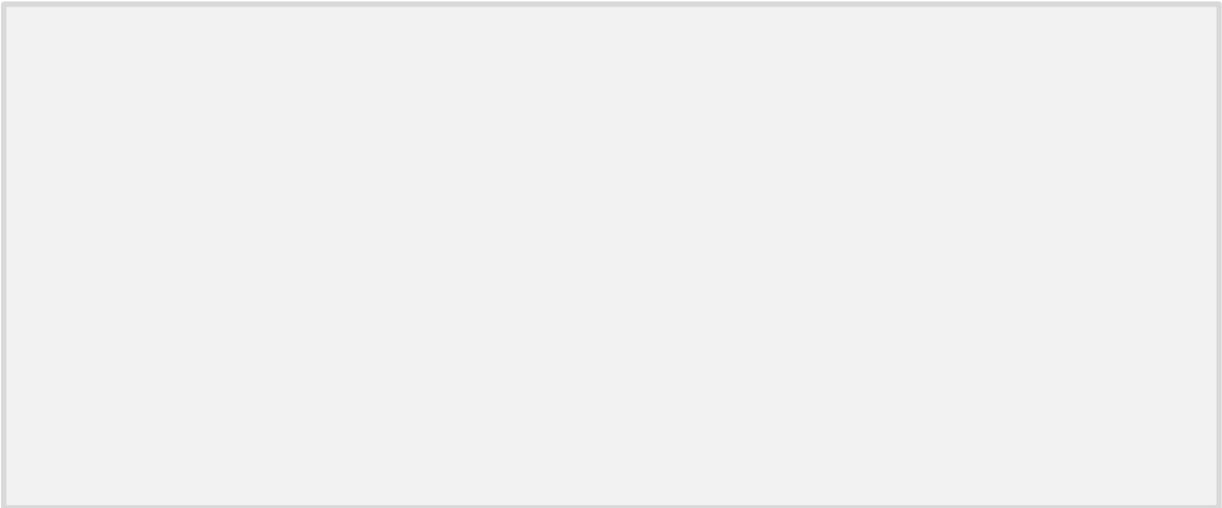
- e) DMRE must develop a transparent NPA application and approval process to ensure adequate evaluation and consultation with key stakeholders including National Treasury.
- f) DMRE must update the NPA pricing framework, setting out the evaluation criteria. NERSA will approve and monitor NPAs in accordance with the framework.
- g) All applications must be treated in accordance with the approved processes and frameworks and be approved by NERSA.

- 7.5.12 A three-year period is relatively short-term, and one would not expect drastic changes in prices or demand. This especially holds true given that ArcelorMittal demonstrates the ability to operate without requiring large network investments, and variable costs, as determined by the MYPD5 (Primary Energy Costs), typically increase by single digits. For this reason, marginal costing is optimum. In addition, as a safety net, the Short-term Framework (STF) makes provision for renegotiations and/or contract termination if either of the parties (Eskom and ArcelorMittal) experiences some hardships during the contract period.
- 7.5.13 Energy losses are added to cover the cost of electrons that will be converted to heat and sound while being transmitted, which will also minimise the burden on other customers. The proposed NPA price and contracted volumes will result in a total revenue collection of [REDACTED].
- 7.5.14 Thus, the parties got to a landing position of PPI + [REDACTED]% through a negotiated price. The negotiated price structure considers the following parameters:
- a) AMSA Saldanha Works' competitiveness and sustainability.
  - b) Electricity price increases that could otherwise be absorbed by other customers.
  - c) Take or Pay Provision.
  - d) Interruptibility – will assist the System Operator in managing the power system (demand response). If the NPA is not granted, the load on the system will decrease significantly and therefore require less usage of OCGTs. In contrast, granting the NPA would keep the customer on the grid, using interruptibility as a mitigating factor in offloading the system.
- 7.5.15 Table 5 below demonstrates the contribution to fixed costs, taking the practical implementation date of 1 July 2022 into consideration.

**Table 5: Marginal contribution to fixed costs**



Source: NERSA recalculation



**Figure 1: Graphical demonstration of contribution to fixed costs**

Source: NERSA recalculation

7.5.16 Table 5 and Figure 1 above assume the effective date of the AMSA Saldanha Works NPA to be 1 July 2022, with the contract ending on 30 June 2025. The duration is equivalent to 36 months, and the average revenue in c/kWh is over 60% above the average cost to supply AMSA Saldanha Works.

7.5.17 The average pricing model is based on AMSA Saldanha Works' cost and revenue profile, as well as rates of the tariffs schedule from Eskom. Upon consultation with other stakeholders, AMSA Saldanha Works submits that it cannot restart operations without the electricity rebate contribution, where

[REDACTED]

7.5.18 This was done to minimise price distortions as required by the EPP Policy Position 14, which states that NPAs are permitted, but must be structured in a way as to minimise price distortions.

The gross profit-sharing mechanism will act as a gatekeeper by ensuring that AMSA Saldanha Works does not make excessive profits for its own gain if the market

conditions improve. Therefore, the provision ensures that any favourable benefit is shared amongst all customers within the Electricity Supply Industry.

## **7.6 NPA Contract Duration**

7.6.1 In terms of the amended framework for short-term NPAs, the applicant may apply for an NPA for a duration of up to three years (36 months).

7.6.2 Eskom is applying for a three-year NPA with AMSA Saldanha Works.

7.6.3 The main reason a three-year duration is suitable is that the three-year NPA will make it possible for AMSA Saldanha Works to restart its operations. It will also assist Saldanha Works in being globally competitive and allow for a transition to the applicable standard tariff. However, there is no guarantee of this; the viability of the operations is dependent on international commodity markets and competitive input costs.

7.6.4 Eskom has supported the three-year duration for the proposed NPA application in the written stakeholder comments and further highlighted that the duration will allow AMSA to restart its Saldanha Bay operations and be competitive on price. However, Eskom further indicated that should projections prove incorrect, as the operation's viability is dependent on international commodity markets and competitive input costs, Saldanha Steel may apply for an NPA extension to sustain the operation.

7.6.5 Therefore, the duration of three years is supported as it will give AMSA Saldanha Works an opportunity to restart its operations and be competitive globally. The period of three years will also allow for certainty within the steel industry.

## **7.7 Technical Benefits of AMSA Saldanha Works NPA**

7.7.1 According to the Framework for Short-Term Negotiated Pricing Agreements, the following technical criteria must be met by a prospective applicant:

1. *Minimum consumption* – meet the minimum consumption requirements of the Short-Term Framework (STF) of 80GWh/annum.
2. *Interruptibility* – all consumers that are granted incentive benefits will be required to provide *interruptibility* when required.

7.7.2 According to the application, the plant will comply with interruptibility requirements by being able to be interrupted by Eskom in periods of high demand, regardless of whether an emergency exists or not. As a result, Eskom must be able to lower the amount of peaking plants required by the system based on the ability to use the smelter for load reductions. In addition, Eskom should be able to use the interruptibility of the smelter to manage grid frequency whenever demand is greater than available supply or visa-versa.

[REDACTED]

7.7.4 The load factor of the plant, after taking into account responses to interruptibility and peak demand reduction, is at approximately [REDACTED]. This [REDACTED]. However, the fact that this plant will be Eskom's baseload customer, consuming power 24/7/365, will assist in the full utilisation of Eskom's committed network capacity.

7.7.5 The 24-hour operation of the smelter will also contribute towards reducing the utility's fixed costs which will have a positive impact on other customers.

7.7.6 NERSA therefore concludes that AMSA Saldanha Works NPA application complies with the technical requirements of the STF for NPAs and will be of technical and financial benefit to Eskom and other users (save for the exception in [REDACTED] above). The approval of the NPA will support the grid through sustainable electricity consumption which will support sustained and increasing economic activity in South Africa (SA). This will better the utilisation of the existing capacity in the Electricity Supply Industry (ESI), which will benefit the economy as a whole.

## **7.8 AMSA Saldanha Works Electricity Consumption**

7.8.1 In terms of section 7.4 of the Eligibility criteria for the amended short-term framework for NPAs, the applicant must consume a minimum of 80 GWh and/or load factor greater than 70 percent during at least two of the past three years in order to apply. AMSA Saldanha Works complies with the requirements of the amended short-term framework as their normal consumption is 700 GWh which is above the minimum requirements of the approved framework.

- 7.8.2 AMSA Saldanha Works is a baseload customer of Eskom consuming power 24/7/365, load factor is projected to reach approximately [REDACTED] at full ramp-up. Electricity is projected at [REDACTED] of operational costs (amongst top three costs), and no competition issues exist as it will be the only producer of ultra-thin steel products (flat sheet and HRC) in SA.
- 7.8.3 The proposed NPA is for a short duration and will assist in returning idle production capacity with the consequential economic benefits accruing to SA. The nature of the scrap smelting process does not lend itself to [REDACTED]. An objective of the STF is the recommissioning of idle capacity, and the revenue generated will contribute to Eskom's fixed costs benefiting other consumers.
- 7.8.4 The application is compliant with the framework as its normal consumption is above 80 GWh.

## **7.9 Impact on Other End-Users**

- 7.9.1 AMSA Saldanha Works will not be subsidised by the rest of the customer base as the proposed NPA tariff has been structured to ensure that applicable costs to serve Saldanha Works are recovered, and a positive contribution is made towards fixed costs. Detailed discussions are in the Tariff Structure section 7.5 above.
- 7.9.2 By providing an NPA to AMSA Saldanha Works, which will assist in bringing back idle capacity, with the variable cost of supply covered, the additional revenue will contribute to the fixed costs. In the absence of this NPA, this contribution to fixed costs would not be realised and would continue to be paid by other customers.

*Impact of the loss of AMSA Saldanha Works demand on the rest of the customer base*

- 7.9.3 Section 9.1 of the Short-Term Framework indicates that applications will be evaluated on their own merits, taking account of the market conditions faced by the applicant and the applicant's competitiveness globally and within SA's borders.
- 7.9.4 The proposed pricing arrangement will contribute to sustaining AMSA Saldanha Works and retaining Eskom's baseload customer at a time when the SA economy is stagnating and appearing to deindustrialise. Therefore, this NPA is seen to support the government's re-industrialisation drive. It will offer Eskom and South Africa financial, technical and economic benefits while ensuring that all other customers in the steel industry value chain are better off.
- 7.9.5 Without an appropriate NPA, the sustainability of AMSA Saldanha Works could result in closure and zero electricity sales and zero revenue to Eskom from AMSA Saldanha Works, which will negatively affect Eskom sales and revenue. It is more beneficial to the rest of the customer base that AMSA Saldanha Works be awarded the NPA, given that it ensures that Eskom can recover some of the costs of existing infrastructure. This cost would have to be fully recovered from the rest of the customer base should AMSA Saldanha Works close its operations. Therefore, the negative impact on the rest of the customer base would be more significant if AMSA Saldanha Works is not awarded the NPA than the impact of the NPA itself.
- 7.9.6 The closure or cutback of production for AMSA Saldanha Works would have an adverse effect on not just the Saldanha Bay economy but South Africa in general, as it would be detrimental to the entire steel industry and cause an increase in unemployment at a time when the country is reeling from job losses in the steel sector. A further consequence is that the SA economy will be negatively impacted via reduced tax and levy collection, the balance of payments/ZAR value, job losses and an increase in social grants burden.
- 7.9.7 Implementation of the proposed NPA, if approved, will result in increased sales volumes, albeit at lower revenue levels. It would serve to minimise the cost under-recovery to Eskom and therefore minimise price increases for other customers, thus ensuring lower average tariff rates than would be the case without these sales.

- 7.9.8 No sales results in the opportunity to earn a contribution to fixed costs being foregone, which would result in other customers continuing to pay the fixed costs.
- 7.9.9 The additional sales from implementing this NPA would also have the effect of moderating Eskom's RCA application for the final years of the MYPD.
- 7.9.10 The figures below show the impact on Megaflex tariff, NPA price breakdown and other customers' costs without the NPA.
- 7.9.11 Table 6 below shows the impact of NPA base price at inception and the impact on other customers without the NPA, and the impact of approving the NPA

**Table 6: Impact of implementation of NPA**

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*Base price at inception*

- 7.9.12 At the base price at inception, Eskom will recover the revenue of [REDACTED] at an average price of [REDACTED] (made up of [REDACTED] energy, [REDACTED] fixed charges and [REDACTED] subsidies).
- 7.9.13 Other customers will have to cover the fixed costs of [REDACTED] (made up of [REDACTED] fixed charges and of [REDACTED] subsidies).

*NPA implementation*

- 7.9.14 With NPA implementation there will be a revenue of [REDACTED] at an average price of [REDACTED] (made up of [REDACTED] energy, [REDACTED] fixed charges and [REDACTED] subsidies).

*Without the NPA*

- 7.9.15 Other customers will have to cover the fixed costs of [REDACTED] (made up of [REDACTED] fixed charges and of [REDACTED] subsidies).

## 7.10 Economic Impact Analysis

- 7.10.1 The purpose of the short-term NPAs is to enable qualifying consumers to sustain and/or increase their use of electrical energy to support sustained and increasing economic activity in South Africa. Section 7.6 on eligibility considers the key strategic and socio-economic impact on SA concerning job retention, beneficiation, taxes and levies and balance of payments.
- 7.10.2 The major economic benefits to SA anticipated from the implementation of the NPAs are summarised as follows:
- Direct and indirect jobs saved by preventing a number of business failures.
  - Direct and indirect jobs saved by avoiding the closure or mothballing of Eskom generation capacity.
  - New direct and indirect job opportunities owing to the restarting of unused productive capacity.
  - Increased economic activity.
  - Lower unit cost of electricity.
  - Higher tax and electricity levy collections.
- 7.10.3 AMSA Saldanha Works is situated in Saldanha Bay in the Western Cape and has been under care and maintenance since April 2020. AMSA has approached Transnet, Eskom, the Western Cape Government and the Saldanha Bay Municipality for assistance with restarting the Saldanha Works operations, converting from the costly iron ore/coke steelmaking model to an electrical scrap smelting model.
- 7.10.4 According to the information provided in the application, the following are key strategic and socio-economic aspects considered in the proposed pricing arrangement for AMSA Saldanha Works:
- a) The proposed pricing arrangement will contribute to sustaining the ArcelorMittal Saldanha Works operations at a time when the SA economy is stagnating, and SA is embarking on an industrialisation drive. The NPA provides benefits to Eskom and SA while ensuring that all other customers are better off.
  - b) The key strategic and socio-economic aspects taken into consideration with the proposed pricing arrangement for AMSA Saldanha Works are as follows:

- i. Alignment to Eskom's mandate and supported by the dtic.
- ii. Being the only supplier of ultra-thin steel products in SA producing 600 000 tons/annum post ramp up.
- iii. Providing certainty for downstream customers in SA.
- iv. The restart would have a positive impact on SA's balance of payments and foreign earnings.
- v. Restarting an operation in SA with associated economic benefits, which would generate both direct and indirect jobs when unemployment in SA is increasing:
  - Direct jobs: 260
  - Contracted jobs: 357
  - Induced jobs: 3 222

7.10.5 The proposed pricing arrangement will contribute to sustaining AMSA Saldanha Works' technology and retain Eskom's single largest customer at a time when the SA economy is stagnating and SA is embarking on an industrialisation drive. Notwithstanding the challenges facing Eskom, it will offer financial and other benefits to Eskom and SA while ensuring that all other customers are better off.

7.10.6 AMSA Saldanha Works has 260 direct employees and 3 222 indirect jobs in the Saldanha Bay area. At full capacity, AMSA Saldanha Works employed 260 direct employees. AMSA Saldanha Works contributes positively to the SA Balance of Payments through the export. Competitively priced local production will also ensure the financial viability and growth of downstream industry.

7.10.7 At full capacity, AMSA Saldanha Works consumed approximately 1.3 TWh/annum (270 MVA) and retained the NMD required for the restart. The restart of operations would result in a post ramp-up consumption of ~700 GWh/annum (225 MVA).

7.10.8 AMSA Saldanha Works beneficiation will be from 100% SA materials from scrap metal and will be the only producer in SA of ultra-thin, high strength steel products (flat sheet and hot roll coil [HRC]).

7.10.9 Saldanha is a town situated at the Saldanha Bay Municipality (WC014) on the west coast of South Africa, approximately 140 kilometres north of Cape Town. According to the Stats SA census (2016), the town has a population of 111 173 and 35 550 households. It forms part of the West Coast District

Municipality (DC1) in the Western Cape Province. The Saldanha Bay Municipality covers an area of 2 015 km<sup>2</sup> (approximately 166 565,48 hectares) and has a coastline of 238km. In total, 6.5% of the geographical land is urban land and 93.5% is rural land.

- 7.10.10 Overall, the Saldanha Bay Municipality constitutes 6.4% of the entire west coast geographical land, making it the smallest municipal area in the district. The area includes the towns of Hopefield, Langebaan, Saldanha, Jacobsbaai, Vredenburg, Paternoster and St Helenabaai. The administrative office of the Saldanha Bay Municipality is located in Vredenburg, with satellite offices in Hopefield, St Helena Bay, Paternoster, Saldanha and Langebaan.
- 7.10.11 AMSA Saldanha Works will contribute positively to the SA Balance of Payments through the export of steel. In addition, the local production of flat steel and hot-rolled coil will also ensure the security of supply of the product in SA and the financial viability and growth of downstream beneficiation industries.
- 7.10.12 The closure or cutback of production by AMSA Saldanha Works will negatively impact the SA economy through tax, reduced and low levy collection, the balance of payments/ZAR value, job losses and an increase in social grants burden.
- 7.10.13 In conclusion, the application is compliant with the requirements of the framework as key strategic and socio-economic impact on SA was provided.

## 7.11 Risk Assessment

- 7.11.1 Table 7 below outlines the risk mitigation to this and other risks identified by both the applicant and the licensee.

**Table 7: Risk assessment**

<b>Risk</b>	<b>Applicant Mitigation</b>	<b>NERSA Analysis</b>
Hardship	Either party shall have the right to give three months' notice in writing to cancel the agreement should unforeseen taxes, levies or duties result in either party facing significant hardship.	NERSA is satisfied with the provision for hardships to mitigate changing financial circumstances of either parties. Revisions to the agreement, as a result of hardship, must be approved by the Energy Regulator to mitigate either party acting unfairly.

Windfall profits	When economic conditions are favorable, AMSA Saldanha Works will share equally with Eskom on an annual basis any [REDACTED], limited to the rebate provided against Megaflex. This is to ensure that AMSA Saldanha Works does not make windfall profits and that the rest of the customer base benefits.	NERSA is satisfied with this provision to ensure that AMSA Saldanha Works does not unfairly benefit from the NPA at the expense of the rest of the customer base, given that the NPA is provided to assist industries in need. The implied incentive rebate for AMSA Saldanha Works, relative to the standard tariff, will be approximately [REDACTED] differential for the three-year duration, depending on regulatory increases.
Cost of supply increasing	Eskom's cost base is being addressed to decrease input costs. The proposed pricing agreement has a commencement tariff significantly above the cost of supply and also provides for a real escalation in the tariff that will alleviate the impact of any real percentage increases of Eskom costs.	The agreement highlights that the base price will increase by PPI to provide price stability for the applicant and transparency for the industry, including the rest of the customer base. The agreement also ensures that the price is set at least at the cost to supply the applicant. NERSA supports this provision as it protects the rest of the customer base by covering the costs associated with supplying the applicant and ensures that the prices increase year on year to keep the differential between the applicant and the rest of the customer base prices as even as possible.
Revenue and demand security/ Take or Pay	Saldanha Works will be liable for a minimum consumption payment based on [REDACTED] of normal consumption of 700GWh/annum, measured over each calendar quarter and adjust to account for substantiated significant events that prevented operating at normal levels, such as initial ramp up, network outages, planned maintenance, furnace outages of a technical nature and industrial action.	NERSA notes the provision to ensure that the applicant consumes at least as much as agreed upon. The provision compels the applicant to meet the committed demand to enable the licensee to have predictability on the revenue to be obtained from the applicant. Should the applicant fail to consume the appropriate volumes and the root causes are outside of the applicant's control, these must be communicated to NERSA to note during its monitoring of the agreement. The take or pay provision holds the applicant to minimum volumes consumed and seeks to shield the rest of the customer base from the reduced

		collection by the licensee. NERSA supports this provision.
Revenue Recovery Certainty	The NPA Framework makes provision for any revenue impact to Eskom to be recovered through the applicable regulatory mechanism. Should NERSA change the methodology that negates this, the parties are to engage to revise terms. If agreement cannot be found either party have the right to terminate giving 3 months' written notice.	NERSA notes the identified risk. However, NERSA will not make changes to the methodology to the extent that voids the existing agreements. However, should there be such perceived changes, the applicant can approach NERSA to get a resolution in this regard.

## 8. CONFIDENTIALITY

- 8.1.1 All the figures are confidential and have been approved by the Energy Regulator as such.

## 9. CONCLUSION AND RECOMMENDATION

- 9.1.1 In light of the evidence presented and analysed above, it can be concluded that under the current terms of the NPA, Eskom will be cushioned from losses by recovering its costs, plus a small margin, through the provision of the variable PPI escalation and the fixed cost increase. Therefore, the deal can be seen as a win-win, both for Eskom and AMSA Saldanha Works, which will restart its operations as a result of the NPA, thus continuing to benefit the local economy of Saldanha Bay in the Western Cape Province and the South African economy at large.
- 9.1.2 Therefore, from the conspectus of the facts and evidence presented to the Energy Regulator, it is appropriate to consider and approve Eskom's application for a three-year NPA with AMSA Saldanha Works.

**End.**

**10. ANNEXURE 1: SUMMARY OF STAKEHOLDER COMMENTS**

<b>1. Eskom</b>		
<b>Category</b>	<b>Stakeholder Comment</b>	<b>NERSA Analysis</b>
<p><b><i>Propose a suitable base price escalation mechanism that minimises price distortions between NPA and non-NPA customers' over the three-year period, but also provides price certainty to Saldanha Steel in Western Cape.</i></b></p>	<p>The application of MYPD increases would not provide applicants with certainty on the price path. The PPI is the relevant base index to which licensee costs should escalate by.</p> <p>Real increases would be a mitigation against cost increases above PPI and to minimise price distortions.</p> <p>A real increase as proposed would minimise Eskom's risk on the cost of supply exceeding the revenue generated but still result in Saldanha Steel remaining viable.</p>	<p>NERSA is of the view that the PPI is the relevant base index by which licence costs should be escalated and is the most preferred in the Electricity Supply Industry.</p> <p>Previous applications approved by NERSA were escalated using the PPI.</p>
<p><b><i>If Saldanha Steel wants to increase the contracted capacity at a later stage during the tenure of the contract, should this additional demand be subject to the existing NPA conditions or should it be considered as a new NPA application that may have different conditions? Should there be a time frame within which to increase the power demand?</i></b></p>	<p>The application is for a specific power demand (contracted capacity) and does not propose an increase in contracted capacity.</p> <p>Any request for an increase in the power demand would not be a part of this NPA and would be subject to a new or revised NPA application.</p>	<p>An increase in the contracted capacity will result in the new NPA application, as the request for an increase after approval is not catered for in the approved framework.</p>

<p><b><i>Comment on the assumption that globally electricity costs make up 50% of operational costs in the basic materials sector and how should NERSA handle this application if Saldanha Steel falls outside this range.</i></b></p>	<p>Steel production is not as energy intensive as other smelting industries, (i.e., globally electricity costs make up a lower % of the operational cost base).</p> <p>The framework requires for electricity to be one of the top three cost items and electricity (at █████ of total costs) would be the second highest cost item of Saldanha Steel, after raw materials.</p>	<p>NERSA notes that electricity (energy) is the highest cost item, followed by raw materials (silica and carbon) for the AMSA Saldanha Works NPA application. This is aligned with the approved framework. However, applications will be treated on a case-by-case basis due to dynamics in each sector.</p>
<p><b><i>Comment on the correctness of this statement in relation to the steel industry and/or similar metals industry. [Electricity price has been cited as the reason for closure or cutback of industries that are sensitive to the price of electricity.]</i></b></p>	<p>Feedback to Eskom from large industry in SA is that electricity costs are impacting their global competitiveness and other countries are providing certain industries with certainty of electricity price path, substantive rebates, and reduced tax and/or subsidy burdens.</p> <p>Relative to other large industry, the steel industry is not electricity intensive, however, the restart of Saldanha Steel is unlikely to occur without the electricity rebate contribution.</p> <p>The primary motivation of the proposed NPA is to bring back production in SA.</p>	<p>NERSA notes the comments raised by the stakeholder. However, a thorough analysis and research will be conducted to assess whether electricity is one of the factors impacting the sustainability of industries in South Africa. There might be other factors impacting sustainability, especially in those sectors where electricity is not the main driver of the costs.</p>
<p><b><i>Propose how the competitiveness factors (except electricity) can be used to improve sustainability of the</i></b></p>	<p>Saldanha Steel has approached other parties for assistance with the restart of the operations (Transnet (logistics), Eskom, the Provincial Government, and the</p>	<p>In paragraph 3.14 of the application, Eskom has indicated that <i>AMSA aim to improve efficiencies and to target niche market so that would enable it to build a</i></p>

<p><b>Saldanha Steel's operations.</b></p>	<p>Local Municipality) and have looked at all opportunities to optimise its cost base.</p> <p>For SA to be globally cost competitive, the country must address all competitiveness factors such as logistics, labour, policy certainty, and not only electricity.</p>	<p><i>sustainable cash positive business.</i> So it is imperative that this information forms part of the implementation monitoring reports to ensure that AMSA is sustainable.</p>
<p><b>Will Saldanha Steel be sustainable after the three years applied for or should it apply for a longer period?</b></p>	<p>Saldanha Steel has indicated that the proposed NPA will make it possible for them to restart and be competitive on price and allow for a transition to the applicable standard tariff.</p> <p>There is however no guarantee of this as the viability of the operation is dependent on international commodity markets, competitive input costs, etc.</p> <p>NPAs should be as short as duration as possible, however, should projections prove incorrect, Saldanha Steel may then apply for an NPA extension to sustain the operation. This would provide the licensee (Eskom in this instance) to review the terms of the NPA and engage with the customer (Saldanha Steel) to amend aspects that pose potential risk to the licensee.</p>	<p>It should be noted that electricity is not the only cost driver; customers must look into other measures such as Energy Efficiency Demand Side Management (EEDSM), state incentives and tax relief where it is applicable.</p>

<p><b>The agreement applied for is a short-term period of three years. Stakeholders are requested to comment on the following:</b></p> <p><b>Risks created by such short-term agreement.</b></p> <p><b>How those risks should be mitigated?</b></p> <p><b>Should such agreement be terminated by hardships, which mechanism should NERSA use to protect the remaining customers from high price increases?</b></p>	<p>The short-term NPA will assist with the restart of Saldanha Steel and provides revenue certainty to the licensee.</p> <p>To limit the deviation from standard tariff, the NPA tariff (initial base price and annual escalation) is set at levels based on projected costs of supply over the NPA period. An additional allowance is added at inception for risk that the assumptions change.</p> <p>NPAs should be limited and alternate funding mechanisms outside of the ESI should be explored to sustain vulnerable sectors.</p> <p>Termination for convenience or hardship removes certainty for both parties and is unlikely to be acceptable. A termination clause should consider unforeseen cost and/or price pressures.</p>	<p>NERSA notes the comments raised by the stakeholder. The funding mechanisms outside of the ESI should be explored to sustain vulnerable sectors.</p>
<p><b>Comment on the proposed NPA, its structure, fairness and impact</b></p>	<p>The proposed NPA is aligned with the short-term NPA framework.</p> <p>The NPA is to restart an operation and will result in incremental financial and other benefits to Eskom and South Africa while ensuring that all other customers are better off.</p> <p>The NPA tariff level considers the sustainability of Saldanha</p>	<p>By their nature, NPAs have a limited duration of three years, six years or 10 years, and the business operations may last for over 50 years, meaning that NPAs are pretty much a temporary relief. Therefore, it is critical that the current pricing within the ESI is changed to cater for the local operations to be globally competitive.</p>

	Steel upon restart and Eskom's cost of supply and is structured to best address and balance the needs of the plant and Eskom.	
<b>General Comments</b>	Eskom is supportive of assisting where it can to further South African industrial policy but the Electricity Supply Industry (ESI) is unable to support all applications for negotiated pricing agreements (NPAs) and a mechanism is required to determine which industries or sectors should be prioritised for electricity price support.	NERSA acknowledges that NPAs are only an interim relief, and there should be a funding mechanism to assist vulnerable sectors outside of the ESI.
	Eskom's preference is for NPAs to prioritise industries where the electricity costs make up a significant percentage of operating costs to have the largest impact on sustainability.	Industries aligned to the industrial policy action plan should be considered, as they have the potential to grow the South African economy and reduce unemployment, which is increasing at an alarming rate.
	The NPA Frameworks make provision for any revenue shortfall to be recovered through the applicable regulatory mechanism, and the consequence is that the remainder of the customer base will subsidise this through further tariff increases. Alternate funding options outside of the ESI should be explored to sustain vulnerable sectors in the economy.	NERSA notes the comments raised.