



# Update on Eskom reforms

## Overview

Government's strategic approach to resolve the financial and operational crisis at Eskom requires structural reform of the utility and the electricity sector.

In February 2019, the President announced that Eskom would be separated into three entities corresponding with its electricity generation, transmission and distribution functions. The primary objective of this restructuring is to facilitate cost efficiencies, optimal investment in infrastructure, improved operational performance and reliability of supply. The separation of the entity will begin a far-reaching transition in the electricity sector, from dominance by a vertically integrated and inefficient monopoly to a competitive and financially sustainable sector. This annexure summarises the underlying principles that will inform the transition.

There has been limited progress in implementing the legal separation of the utility. In addition, Eskom faces periodic cash flow crises, necessitating support to the value of R49 billion in 2019/20, of which R13.5 billion has been transferred to date.<sup>1</sup> Further requests for short-term financial support in the current financial year are limited to the remaining balance of R35.5 billion, which will be transferred in accordance with Eskom's cash flow requirements, pending the enactment of the appropriation bills.

## Short-term stabilisation measures

The immediate priority is to stabilise Eskom's financial position. The 2019 Budget included provisional government support of R230 billion over 10 years to support Eskom's balance sheet and restructuring. Table C.1 shows the revised allocations to Eskom over the medium-term expenditure framework.

**Table C.1 Revised medium-term allocations to Eskom**

R million	2019/20	2020/21	2021/22	2022/23
2019 Budget baseline	23 000	23 000	23 000	23 000
Proposed changes	26 000	33 000	10 000	–
Revised 2019 MTBPS allocation	49 000	56 000	33 000	23 000

Source: National Treasury

<sup>1</sup> The amount of R49 billion in the current year includes R23 billion announced by the Minister of Finance in his 2019 Budget Speech – an amount set aside for each of the next 10 years – and R26 billion tabled in a Special Appropriation Bill in July 2019. The R17.7 billion approved for disbursement under section 16 of the Public Finance Management Act (1999) in April 2019, forms part of the R23 billion, of which R13.5 billion has been transferred to Eskom to date.

The proposed additions to the amounts identified in the 2019 Budget are intended to help Eskom maintain its going-concern status, which requires the utility to meet its financial obligations as they become due. If Eskom is unable to issue debt in the financial markets, or the cost of doing so becomes prohibitively expensive, government may be called upon to provide further support to enable financial obligations to be met. The total cost of Eskom's annual debt and interest payments averages R85 billion over the next three years.

## Assessment and timeline for restructuring

The Ministers of Finance and Public Enterprises have appointed independent financial experts to:

- Assess Eskom's daily cash flow management to eliminate continual requests for government support.
- Determine the degree to which operational efficiencies are being implemented across the business. This includes considering whether capital expenditure should be halted or deferred given Eskom's weak financial position.<sup>2</sup>
- Monitor implementation of the operational turnaround plan, particularly the performance of the generation division.

To date, following discussions with Eskom's chief restructuring officer, government has agreed to the following proposals:

- The primary objective of separating Eskom's corporate structure into three transparent business units is to facilitate cost efficiencies, optimal investment in infrastructure, and improved operational performance and reliability of supply.
- The capital structure will be modified to reduce and ultimately end Eskom's reliance on government support. Debt relief will only be considered once operational efficiencies have been achieved.

Government has set a two-phase timetable for Eskom's restructuring:

- Phase 1: Functionally separate the generation, transmission and distribution functions into separate, wholly owned subsidiaries with independent Boards by 31 March 2020.
- Phase 2: Complete the legal separation of distribution and generation functions by 31 December 2021.

This timetable requires an urgent and focused response from Eskom management and the Board, as well as focused work across government to resolve a number of structural issues that impact Eskom's financial viability.

## Debt relief considerations and conditions

Eskom's R441 billion debt portfolio at 31 March 2019 is well beyond what it can afford to hold without government support. While this level of unsustainable debt must be reduced, the underlying causes must also be addressed. Eskom is plagued by operational inefficiencies. It has suffered cash losses as municipalities and other entities have not paid their bills. And it has received tariff determinations from the National Electricity Regulator of South Africa that do not allow the utility to recover its costs. Any proposed resolution must address these fundamental concerns.

The National Treasury has considered various options for reducing Eskom's debt burden. Without major operational and governance reforms, however, debt relief will only provide a temporary reprieve for the loss-making utility. Consequently, the National Treasury, in consultation with the Department of Public Enterprises, has set a number of preconditions before debt relief will be considered.

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<sup>2</sup> These decisions will have to be balanced against implications for electricity supply, and potential penalties and preservation costs.

The Eskom Board is required to:

- Demonstrate measurable progress in instilling rigorous cash management discipline, and in achieving operational efficiencies in the business.
- Show that all business units are managing operations within their means.
- Create the three new functional entities, with the separation of the transmission function being the priority.
- Appoint new Boards and CEOs with the requisite skills for the three entities, who are accountable for the independent operation of each entity.

The National Treasury anticipates that some debt relief will be provided to Eskom over time, as operational and financial performance improve. Most operational changes are expected to be implemented before the end of 2021. This approach will support an efficient debt relief arrangement and strengthen the finances of the newly created entities relative to Eskom in its current form.

The debt relief process will be managed to ensure that:

- The integrity of the budget process is maintained.
- The credibility of the fiscal framework remains intact.
- The state's contingent liabilities are reduced.
- Any default and cross-default on total Eskom debt is contained.
- Creditors are treated equitably.
- Confidence returns to the capital market and bilateral funders about Eskom's borrowing capacity.

Eskom, with government support, will consult with its funders on detailed plans for debt reorganisation in due course.

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