Casting, Forging and Machining Cluster
of South Africa NPC

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Consultation document: Impact of international gas prices, interim methodology, and review of methodology to approve maximum prices of piped-gas

To whom it may concern,

Thank you for the opportunity to provide a response to this Consultation document, as published. We believe that it is very important for industrial users to become more involved, and to make use of opportunities like this to share opinions, to present advisory inputs, and to engage with NERSA in a value chain focused debate, seeking to improve the competitiveness, at all levels of activity, in the manufacturing sector.

<u>About the CFMC</u>

The Casting, Forging, and Machining Cluster of South Africa NPC (CFMC) is a nonprofit, industry-led cluster initiative to develop and grow manufacturers and associated service providers in the casting, forging, machining and associated manufacturing industries. Members of the CFMC are committed to working together to address the challenges facing them and the local industry in South Africa. CFMC is committed to strengthening linkages between manufacturing companies and institutions, including economic regulators, like NERSA. Also necessary is relationship building and collaboration alliances with the government and industry support structures, with the aim to stimulate capacity development and improve competitiveness of South African companies and the products that they make locally. Localization and import replacement are the major focus points that will headline the cluster's plans to initiate this process of change.

The CFMC and its members are primed to play their part in the revitalisation of the South African metals industry. Together the collective bargaining power, great structures and open cooperation of the cluster and its members can forge forth a South Africa first industry, which rewards locally produced cast and forged core products, improving local manufacturing and contributing toward job creation. CFMC has a Board, and is managed by a Steering Committee of elected leaders.

Our members consist of mini-mills, foundries, forges, heat treatment plants, machine shops, metal processing plants, as well as component manufacturers. Most are high energy users, supplied through municipal licensees. This group of Municipal industrial users is calculated to consume approximately 19% to 20% of the electricity that Eskom generates, and serves to provide a significant portion of the employment opportunities in the country.

Background

Manufacturing businesses have a choice to make in the selection of the most cost efficient source of energy for their operations. It is a business case that results in private investments into on-site infrastructure, and the deployment of appropriate policies and procedures and, and training. Where it is available, gas has been a preference over other energy sources in the conversion of minerals and metals in particular. As a result, the use of gas by members of the casting, forging, and machining communities is high, relative to some other industries.

Before embarking on a response to the Consultation Document, it is important to ensure that the right costs are apportioned to the right sources of gas. Our members have identified that SASOL has a number of gas pipelines, and gas supply contracts. Our concern, and the issue we want to highlight, related to the gas pipeline from Secunda to the Highveld Complex in and around the Nkangala District Municipality in Mpumalanga. The gas piped from Secunda was subject to an agreement in which there was an opportunity for SASOL to rid itself of excess gas, a residue of its coal to petroleum conversion process, to willing buyers in the Highveld Complex. Part of this private agreement included a mutual understanding that the “waste” gas supplied would have lower calorific values than other piped gas, and that the gas would be priced appropriately to incentivise usage of this resource.

To our understanding, NERSA does not recognise this and other private agreements, and accordingly, does not account for the discount of gas prices, in such instances. We recommend that the contents of such agreements are revisited, and suggest that, where possible, “waste” gas is used in such a manner by industrial users, as opposed to being burnt, or otherwise disposed of.

We are concerned that SASOL is continuing to apply pressure on users, and despite trying to generate awareness to some of the challenges faced, is mixing messages, by at the same time, trying to convince users to sign non-binding off-take agreements to support their motivation for investment into additional gas fields.

Enabling Public Participation

The NERSA Consultation document contains detailed history and theory and provides an extensive record on how prices are formulated. It is, however, information overload, and confusing to most people that may want to express an opinion. The information should be easy for the average industrial user of gas to understand, and should provide sufficient information so that users are able to reach a sensible conclusion. From our perspective, there are mixed messages in the Consultation Document, leading us to suspect that the entire proposal to change the methodology serves an agenda complimentary to the Monopoly supplier and only will serve to further drive-up costs of manufacture in South Africa to the detriment of the entire SA Economy.

International prices

We understand the cost pressures, and anticipate that prices will continue to fluctuate, for as long as the geo-political environment remains volatile. Whilst we are not happy with the price movements, we would prefer to make sure that the price setting processes do not disadvantage members, and that other costs are not allowed to overly burden the manufacturing cluster.

We foresee several factors being taken into account and associated costs being clearly identified and published in any agreements that might be signed and on the invoices posted for services rendered.

As we understand it, the courts have ruled on the old methodology and made findings that pushed NERSA to adopt the new pricing methodology. We do not see how this can be avoided, and how the change back to the old system would benefit us.

Surging international prices

We anticipate that the price surge will have a dramatic effect on traded gas prices, and on the market. Increases of over 200% are cited. Not surprisingly, there is a fear that increases of that magnitude will have disastrous impact on manufacturers using gas, as domestic competitors using electricity as their source of energy, will be at an immediate advantage. Due to the different infrastructure needed, a manufacturer in the gas supply chain cannot switch between sources with ease.

Sources of Gas

Over and above the sources of gas mentioned in the Discussion Document, recognition is also needed for local gas supplies, generated through:

1. circular economies, and efficient use of the waste generated from operations, for instance, the SASOL coal to petroleum processing mentioned above, and
2. Local exploitation of gas reserves in South Africa, and SADC.

We anticipate that local gas reserves will need to be suitably managed to provide local manufacturers access to these reserves to support manufacturing retention and expansion over an extended period. Pricing would be based on cost of supply, rather than international benchmarks, until evidence shows otherwise.

FRom what we understand, the Gas Master Plan and its forecast of local gas has not been taken into consideration. We anticipate that prices of local gas should not be set by international benchmarks, and that more discussion is needed with regard to domestic gas sources and pricing around the Gas Master Plan process.

The business case for gas

If sustained, the international prices will cause manufacturers to seek long-term alternatives to gas, to reduce risk, and increase reliability and efficiency. These are strategic decisions that the industry must make, based on the information available at the time. Once implemented, industry is committed to that energy source (gas), which is not easily changed due to capital considerations. Pricing stability is needed once the base case for gas is made, which for many users, dates back to when the service was initiated. The methods applied to set and monitor prices are important, and should only be changed if absolutely necessary, and even in that case, with care, and consultation. NERSA should not seek to implement fundamental changes to Gas Pricing by changing the methodology as it can have an enormous consequential impact on the users of the energy.

Note: As renewable energy and battery storage becomes more accessible, the business case favouring gas is anticipated to start weakening.

That said, however, the change is not anticipated to happen in the short term, as the manufacturing processes in the cluster are such that manufacturers are unable to depend on renewable energy alone, until cost effective solutions to energy storage are found.

Monopoly Suppliers

Any form of binding agreement signed between SASOL and users, to secure off-take commitment, would be uncompetitive unless preferential rates are agreed as part of the agreement. We suggest that the Competitions Commission is involved, whenever there is a monopoly in the supply chain.

Pricing Methodology

We agree with the principle to share economic surplus between SASOL and its consumers, but cannot see how that process, linked to the old methodology, can be applied in the current environment. Similarly, we agree that a price cap may be needed, to help manage price surges, but would need a framework to regulate the process, which as far as we understand is not contained in the Consultation Document.

We prefer an open market option to a monopoly.

Further consultation is needed to answer our questions, and allay our fears.

Cost of Supply

The capital cost of installing and maintaining infrastructure for the distribution of gas, needs to be properly motivated and discussed. SASOL has embarked on a process to improve awareness of some users, and to solicit non-binding commitments, to underwrite their investment commitments. These processes should be transparent and serve to increase awareness, rather than to cause suspicion and doubt, as the case now. Please engage SASOL and align the activities around a business case that we can understand. SASOL is an importer of Gas, and as a monopoly is afforded a substantial reimbursement for what is, in essence, a trading activity (28.57%,). If that is indeed the case, we suggest that value is excessive, as it is already reimbursed as part of the distribution costs, and propose that no reimbursement is needed.

Other concerns

1. Transmission and Distribution costs are an important part of the bigger cost discussion, but are not referenced in the NERSA proposal.
2. Consideration should be given in the methodology to gas efficiencies (per kWh). By our analysis, the conversion efficiency rate for electricity generated from gas, or for the melting of copper (a non-ferrous metal) is similar, at between 38% and 42%.

The Department of Trade and industry would have us believe that growing manufacturing output in South Africa is a government imperative. If that is so, then it is clear that we need to help manufacturers in whatever way that we can, to be more competitive. We can no longer expect the manufacturers will absorb costs that arise through unjustified add-ons and pass through practices.

Proposal

A. We strongly suggest that the best outcome for the economy in its current state, is to use a low risk approach to enhance recovery, and job creation.
B. Excessive margins beyond 10% should not be entertained.
C. The proposal needs to be presented to smaller users, and in place of open ended questions, NERSA are to provide costed proposals for us to comment on.

We hope for a favourable response to our proposals above.

The CFMC look forward to engaging with NERSA and other stakeholders in support of our objective to grow manufacturing in this cluster

Regards
Steve Jardine
Managing Director
11 April 2022