

27 February 2019

Zondo Commission – Struggling Optimum helped to its doom by Eskom

Former chief executive of Glencore, Clinton Ephron, has told the commission of inquiry into state capture how a struggling Optimum coal mine was at Eskom's mercy for years while negotiating for an amendment to their coal supply agreement (CSA). This would take the form of a price increase for coal purchased by the power utility for the Hendrina power station. Their hopes were shot by then acting CEO Brian Molefe in May 2015, months after the company had been under the impression that the document was at board-approval level.

The news was devastating to Ephron, because of the long-standing history between the two companies. Optimum had survived only through shareholder funding for some time, while operating at losses of between R80-million and R100-million per month. Glencore had at some point injected an amount of R450-million to help carry operational costs at Optimum, but this was not a sustainable solution.

The anticipated approval of the power utility's board was the only way Optimum would manage to stay in business. Negotiations had started in 2011, when Glencore approached Eskom to address the pricing issue, but it was not until 2014 that a formal structure was established on either side that would lead to the "fourth addendum."

Ephron wrote a letter to Eskom later in May, after their meeting, in which he cited the prospects of business rescue, and degree of losses to shareholders, if Eskom did not reconsider. To that end, Ephron said, Optimum had been under the impression that Eskom's board tender committee had in essence approved the addendum, with only the board's green light outstanding. Molefe did not respond to the letter, until June, after a second meeting with Ephron to tell him that Eskom was not willing to negotiate.

The best that Eskom could do, Molefe told Glencore, was to propose that the two negotiation teams go back to the drawing board and re-create a new CSA, that would consider the lifespan of Hendrina. He added that Eskom was not in a financial position to meet the demands of Optimum, to that extent.

During the initial negotiations, Ephron told the inquiry, there was a strong sense of the addendum being approved by Eskom as there were no critical issues arising from an operational point of view. During the negotiation period, an arbitration process, established to decide a new pricing structure for the contract, was suspended with the hope that the addendum would override the queries raised in it.

Discussions over the fourth addendum to the original CSA came about after the two companies decided that an overhaul of the entire agreement would be cumbersome. At that point, there was no reason for Ephron to believe that Eskom would not approve the change.

Prior to this revelation, Ephron took the inquiry through a period before Glencore's takeover of Optimum, during which the business model of cost plus margin was in place. In his opinion, Eskom would be paying less for coal if it had continued on that model, instead of moving to a fixed price model, in the 1990s.

In the case of the cost plus margin, Eskom carried the costs of mining the coal, including the coal generation. If this is managed well, said Ephron, they would only pay for the cost of the coal, without market fluctuations becoming an issue.

Useful links:

[Zondo Commission website](#)

Corruption Watch's [Zondo Commission update page](#)

[National Treasury](#)

[Eskom](#)