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POWER TO THE PEOPLE

SUBMISSION BY SOUTHERN CAPE KAROO ELECTRICITY FORUM REPRESENTING THE FOLLOWING MUNICIPALITIES, DISTRICT MUNICIPALTIES AND TRADE UNIONS:

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1. CABINET DECISION : 14 SEPTEMBER 2005

The following communiqué was released by Government Communications (GCIS) after yesterday's (i.e. Wednesday, 14 September 2005) cabinet meeting:

"Cabinet was briefed on a plan to accelerate the implementation of Regional Electricity Distributors (Reds), including the introduction of a Bill on Electricity Distribution Industry Restructuring. In this regard, It was agreed that six metro REDS needed to be set up as soon as possible after the local government elections, and that other areas would be covered under separate local REDS or a National RED. Eskom would continue to play a critical role particularly in the National RED"

The above communiqué also appeared as part of an article in today's (i.e. Thursday, 15 September 2005) "BUSINESS DAY" newspaper (main section, page 3).

1.1 The Revised Approach (Extracted from SALGA Report dated 22 March 2006)

The revised approach calls for the establishment of the Metro Reds after the March 2006 Local Government Elections. The four ministers, DPLG, NT, DME and DPE were mandated by cabinet to decide on the boundaries for the National RED/s based on the outcomes of a process (modeling) to determine the viability and sustainability of the RED/s. SALGA has been part of this process at a technical level and is concerned about the impact of the revised approach to municipalities particularly if the proposal for one National RED led by Eskom in addition to the Six Metro Reds is adopted. Given this concern, SALGA calls for the respect and recognition of the following key principles that were agreed upon to guide the Electricity Industry Restructuring process;

(a) Restructuring must be conducted in accordance with the Constitution, taking into account that the responsibility of electricity reticulation is a municipal function;

(b) The Financial state of municipalities currently performing the electricity function must not be adversely affected;

(c) Any RED end-state model must meet the restructuring objectives set out in the EDI Blueprint that was approved by Cabinet before.

The original Reds boundaries were designed in such a way that they enabled the incorporation of Eskom Distribution into the six Reds. The proposal for Eskom to be the anchor in the National RED is in conflict with the cabinet decision of phasing Eskom out of distribution as it now suggests that municipalities outside the Metro Reds will be incorporated into Eskom. SALGA recognises the fact that most of the 187 municipalities that are licensed to distribute electricity are operating at a loss and will benefit if incorporated into a National RED.

However we are concerned about the impact of the National RED to category B municipalities such as, Umhlathuze, Buffalo City, Mangaung, etc, as they are currently operating viable and sustainable distribution. The revised approach should allow viable category B municipalities to form Reds and together with the Metro Reds incorporate neighbouring municipalities with the balance going to the National RED. The original Six Reds model should be kept as a default, given the amount of communication that went into it and the low number of Reds.

1.2 Recommendations (Extracted from SALGA Report dated 22 March 2006):

1) The modelling results be presented to the ministerial committee in full considering the viability and sustainability of all the five scenarios that were modelled
2) The emphasis and preference of six metro reds and one national red scenario by some stakeholders be discouraged as it is not based on the outcomes of the modelling exercise
3) The modelling results to be considered by the ministerial committee should be that of the modelling done by EDI Holdings as mandated by cabinet and not that of Eskom
4) **Note the category B municipalities discomfort with joining the National RED, and preference for a cluster RED with adjacent municipalities**
5) Eskom distribution assets to be transferred to the Reds should include key customers as per the original six wall to wall Reds model and EDIR blue print
6) The ends state and or the restructured electricity distribution industry should have the Reds as the only distributor to all customers, domestic, industrial, key customers, etc.

7) Uphold, respect and recognize the following key principles that were agreed upon to guide the Electricity Industry Restructuring process;

   a. Restructuring must be conducted in accordance with the Constitution, taking into account that the responsibility of electricity reticulation is a municipal function;

   b. The Financial state of municipalities currently performing the electricity function must not be adversely affected;

   c. Any RED end-state model must meet the restructuring objectives set out in the EDI Blueprint that was approved by Cabinet earlier.

8) Metro Reds be implemented on the basis of lessons learned from the RED One experience, looking at what worked and what did not work

9) The issue of Assets transfer is critical and should get more attention at local level possible, guided by principles agreed upon at the National level between DPE/Eskom and organised local government

10) Note the concern about tax implication from asset transfer to a municipal entity and call for detailed investigation on this matter by NT and tax exemption where possible

11) Key customers be transferred as part of overall Eskom distribution assets transfer to the Reds

2. SOUTH CAPE KAROO ELECTRICITY DISTRIBUTOR (PTY) (LTD).

2.1 Background (See Document SCKED PTY (LTD)

National Government is busy with a process of restructuring the Electricity Distribution Industry (EDI). Local Government agrees that the EDI needs to be restructured because of various factors as have been identified through the national process. The proposals that have been put forward by Price Waterhouse Coopers (PWC) will have serious impacts on Local Government (LG) if implemented. EDI Holdings have after the cabinet decision of 14 September 2005 embarked on a modelling exercise which resulted in the comparison of the 6th RED model versus the 7th RED model. The final proposal from EDI Holdings is that the 6th RED model is financial more viable than the 7th Red model.

EDI HOLDINGS FOUND THAT THE SCKRED MODEL IS VIABLE IF MEASURED AGAINST THEIR CRITERIA.

The South Cape Karoo Electricity Forum has also been busy with restructuring investigations since 1992. The proposals made by the Forum are very different to that proposed nationally. The objective of this discussion is to highlight the differences between the two approaches and estimate the financial impact of the two options.

2.2 DISCUSSION

It must be realised that the final PWC proposals were not made available to many stakeholders and therefore various of the finer details are not that clear and were in fact not clearly defined. The table below indicates the key features of the two approaches with a perspective of the financial impact on LG. The comments will be made from a LG perspective. In other words a negative perspective will mean it is negative for LG. This will mean that the financial pressure on LG will increase. This will affect all aspects of LG negatively in that tariffs will have to increase and costs will have to be reduced. The key issues to be analysed are as follows:

Once off impacts

- Cost of stranded resources to the LG.
- Cost of downsizing of municipality services and operations capabilities impacts).
- Costs associated with transfer of assets and employees to Reds.

Recurring cost impacts

- Partial or total loss of the surplus revenue derived from electricity sales.
- Higher cost of electricity supplied to municipalities by Reds.
- Cost of maintaining and expanding street lighting and other LG electrical services.
- Absorption of municipal government overhead costs now allocated to electricity undertakings.
- The cost implications of reduced municipal government cash flow.
- Lower credit rating impacts.
- Municipal government debtor management (electricity disconnection leverage).
- Net increase in VAT payments.

2.3 QUALITATIVE DESCRIPTION

A qualitative description of the two approaches is described in the table below

	SOUTH CAPE KAROO	NATIONAL – 6 REDS / 7 REDS
ONCE OFF COSTS		
Cost of stranded LG resources	The impact should be minimal because the proposal is that resources will be shared wherever possible. For example one resource can be used to read electricity and water meters. This can either be in the RED or the LG and the one will charge the other for the service provided.	Very large impact as electricity supply will be done by a separate company with very little co-operation with the LG. All resources of the LG currently supplying services to electricity will be stranded. Very few will be accommodated by the RED.
Downsizing of LG services.	The South Cape proposal is that resources will be shared wherever possible. Negotiations will be undertaken in a fair way to ensure that some of the stranded resources are taken over by the RED.	Various of the services in the LG have been set up to also support electricity. With electricity removed being removed in total, various of these services will have to be downsized leading to possible job losses.
Assets & employees transfers	Dedicated electricity assets and staff will be transferred to the RED. This will also involve some costs. The difference is that it will be done with a lesser extent of moving of resources, more buy in by local staff and LG being in a strong negotiating position to protect its staff and resources.	Dedicated electricity assets and staff will be transferred to the RED. This will involve a significant cost. Shared assets will probable end up as stranded costs for the LG because LG will be the smaller party in negotiations where Eskom (National Government) will rather favour taking over their own assets and leaving LG assets as stranded to LG.
RECURRING COSTS		
Control of surpluses	LG income will be from LG tax mainly not from dividends. Setting of LG tax will be 100% under control of LG for all sales in area of jurisdiction. This will be set by LG subject to national limits. Exceptions can be made by LG to promote any specific industry or other activity.	Main source of income will be from dividends paid out after tax on profit made by the RED. This will be jointly decided by all owners of the RED of which LG will nationally have less than 30% of the share.
Higher electricity costs for LG own use	Minimal impact as it is not expected that the price of electricity in the region will rise above the current levels in real terms because of restructuring.	Indications are that real price of electricity will increase by close of 40% in real terms for industrial and commercial applications because of restructuring.
Streetlight lighting and own electricity maintenance.	The same resources as currently will be used to provide RED and LG electricity services as is currently the case specifically in smaller towns where separate resources are not warranted.	The PWC proposal is for a totally independent RED which will do what it wants and leave the LG to do its own thing. This will lead to the LG to have to employ resources that will be expensive for the LG.
LG overheads to Electricity	It is proposed that the lost revenue due to the fair overhead allocation will form part of the LG tax to be established and thus no revenue loss to LG.	The PWC proposal makes no provision for some compensation of these lost revenues for LG. This will lead to a large stranded cost for LG.
Reduced LG cash flow	The LG cash flow will be structured in such a way that the payments will be made every month at a day of the month to retain the LG in the same cash flow situation as at present.	Furthermore the major part of the revenue will only be received once or twice per year thus placing a major cash flow impact on the LG.
Credit rating impacts	LG will own 100% of the RED and will thus be able to include the electricity revenues as part of its revenue. LG's credit rating should therefore not be affected negatively at all.	The PWC proposal will allow LG a very small shareholding, less than required to consider the cash flow as part of the LG cash flow. This will have a negative impact on the LG credit rating leading to higher interest and bank overdraft costs.
LG debtor management	It has been agreed that the RED will have an agreement with the LG's to either cut-electricity supply if LG services are not fully paid up or not to allow pre-payment electricity purchases when LG services are in arrears. LG will thus not be worse off than at present.	The RED will be an independent company with minority LG shareholding. Electricity cut-offs will continue to be used as a revenue collection measure. LG will not be able to cut electricity when other LG charges are not paid. This will increase non payment on these services.
Increased net VAT payments for LG	The LG will have to pay more VAT because it will not be able to claim back the same amount of VAT as in the case when electricity if part of the LG. This impact seems to about 1% of electricity sales.	The same impact as for the 6 Red's/ 7 Red's will apply. The difference is that this should be recovered as an additional levy on electricity sales.

2.4 FINANCIAL IMPLICATIONS

It would be naïve to think that the impact of any restructuring will be zero for any of the restructuring options. Therefore also the South Cape Karoo proposal will involve some initial negative financial impact on LG. It is however expected that the short term losses will be made up by significant improvements in the level of electricity services in the region and lower costs of electricity for all electricity users thus leading to growth and prosperity for the region. The whole process of amalgamating LG's also have as a prime driver to rationalise the number of LG so as to reduce the cost of providing the various services. There is therefore also a need to reduce some of the costs of LG. This reflects the need to make a smaller cost allocation to electricity.

Assumptions have to be made to estimate the impact of the various issues. The following conservative assumptions have been made in respect of each of the issues:

ONCE OF IMPACTS.

Cost of stranded LG resources

6 REDS / 7 REDS.
To assess the actual stranded resources will require extensive analysis not available at this stage.

South Cape Karoo RED.
This will also require extensive analysis but it is expected that the total impact will be significantly less due to the co-operative nature of the proposed South Cape Karoo RED.

Downsizing of LG services.

6 REDS / 7 REDS.
The LG will have to downsize the level of its operations. A detailed analysis is required in this respect. The majority of the impact is however captured in the lost administrative allocation to electricity already captured.

South Cape Karoo RED.
he only impact will be in the extent to which the administrative charge to electricity is recovered by the LG tax and this will be by mutual agreement between the parties.

Assets & employees transfers

6 REDS / 7 REDS.
he cost of transferring assets and employees require extensive analysis which has not been done to date yet. No estimate will be done at this stage.

South Cape Karoo RED.
It is expected that less staff and assets will be transferred but no extensive analysis has been done.