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**Electricity Regulation Amendment Bill (B20-2006)
Parliamentary Portfolio Committee Hearings
Submission by EDI Holdings**

10-11 October 2006

Presentation Outline



- * Introduction
- * Regulating the South African Power Sector
- * EDI Holding's recommended approach
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- * Proposed EDI Restructuring legislation
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INTRODUCTION

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Introduction

- * EDI Holdings is a public entity, established by national government to project-manage EDI restructuring.
- * Comments deal with the Bill's implications for the restructuring programme and the overall EDI governance system.
- * Scope of municipal authority over the EDI should be defined to clarify the respective roles of local and national government, facilitate restructuring and ensure the orderly regulation of a restructured industry.
- * The Bill's proposed definition of electricity reticulation has unintended consequences for industry restructuring.
- * Reforms should separate the 'player' from the 'referee', as is presently the case with NERSA as the professional independent regulator of the entire ESI.
- * Legal opinion suggests that a legislated definition of reticulation which attempts to restrict local government's executive and legislative authority over the EDI could be subject to Constitutional challenge.

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REGULATING THE SOUTH AFRICAN POWER SECTOR

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Regulating the South African power sector

- ❖ Economic regulation is concerned with monopoly practices within any of the four components of the ESI:
 - **Generation:** Theoretical potential for competition. Eskom's monopoly makes economic regulation of generation essential;
 - **Transmission:** A classic natural monopoly. It is not practical to build parallel infrastructure. Regulation is therefore essential;
 - **Distribution (Wires business):** Transfer of power over short distances using medium and low voltage lines. A classic natural monopoly. Regulation is therefore essential; and
 - **Trading (Energy business):** Sale of power over transmission and distribution systems. Theoretical potential for competition. No market structure in South Africa. All retail tariffs therefore require regulation.
- ❖ Although the Constitution allocates legislative and executive authority over "electricity reticulation" to local government it does not provide an explicit definition of the term "reticulation".

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Regulating the South African power sector (...2)



Implications of the proposed definition of reticulation:

- * Firstly, the implications for the **structure** of the industry are not clear:
 - Many distributors currently supply to both reticulation (under 5000 MWh pa) and distribution (over 5000 MWh pa) customers.
 - Regulated activities must be clearly ring-fenced in separate business entities to enable sound regulation. The Bill appears to require a *major restructuring* of existing distribution businesses, without which regulation will not be feasible.
 - In practice it will be very difficult, if not impossible, to *divide assets* between reticulation and distribution businesses.
 - The implications for *asset ownership* are also unclear.
 - If distribution assets are not separated from reticulation assets, two customer categories on the same network could be regulated by separate regulators, thereby leading to *differing tariffs* above and below the 5000 MWh pa borderline.
- * Secondly, it is unclear whether the definition is intended to cover **all distribution** and trading of electricity to the defined category of customers within a municipal area, or only trading in and distribution of electricity *undertaken by the municipality*.

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Regulating the South African power sector (...3)



Implications of the proposed definition of reticulation:

- * Thirdly, in recognising and giving effect to local government's right to undertake economic regulation of the bulk of the EDI, the Bill creates the risk that the **quality of economic regulation** will be substantially degraded.
 - Municipalities have an inherent conflict of interest between their role as regulator (referee) and their role as owner/operator (player). The outcome of this conflict is evident in the many distortions in present-day municipal electricity tariffs.
 - National government is able to manage this conflict by separating its ownership function (housed in the Department of Public Enterprises) from its regulatory function (housed in NERSA).
 - It is not viable for every municipality to establish and maintain an arms-length professional regulator. Economic regulation by municipalities is therefore bound to be ineffective.

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Regulating the South African power sector (...4)



- * It will only be possible to restructure the EDI in a reasonably efficient and predictable manner if national government has authority over the EDI which goes further than its current supporting role.
- * It is essential that national government has *executive authority* over the structure and assets of the EDI, which need not exclude municipalities from having executive authority over certain aspects of EDI governance.

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EDI HOLDING'S RECOMMENDED APPROACH

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EDI Holdings' recommended approach



- ✧ The most practical way to ensure that national government has regulatory powers over the ESI and that EDI reforms take place, is to give national government appropriate executive authority in respect of the EDI, while leaving appropriate executive authority with local government.

- ✧ It is appropriate for municipalities to have the power to: –
 - apply municipal surcharges to electricity sales within the municipal area, within the bounds of national regulations;
 - make social regulations, including the power to compel distributors to undertake electrification, on provision of appropriate capital subsidies and to compel distributors to provide free basic electricity supplies to indigent households in accordance with municipal integrated development plans and on provision of appropriate operating subsidies; and
 - compel distributors to undertake electricity cut-offs on municipal request, within appropriate limitations.

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EDI Holdings' recommended approach (...2)



- ✧ The following powers should be exercised centrally, by national government or the relevant regulatory institution: -
 - the power to make *technical regulations*, via appropriate regulatory agencies (in this regard, it is felt that the existing system for technical regulation, involving a combination of SABS, NERSA, DME and various industry bodies is adequate and should be maintained);
 - the power to make *environmental regulation*, via appropriate regulatory agencies (in this regard, it is felt that the existing system for environmental regulation is adequate and should be maintained);
 - the power to undertake *economic regulation* of the ESI, via an independent third party regulator – namely NERSA;
 - the power to *restructure* the ESI, including the EDI.

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EDI Holdings' recommended approach (...3)



- * The most legally viable mechanism to entrench these powers and functions for national and local government is not only through legislation but also through *constitutional amendments*.
- * Any suggestion of constitutional amendment will be viewed with understandable scepticism and suspicion. However, given the fundamental problems which arise if economic regulation of the EDI remains with local government, serious consideration should be given to this option.
- * Any constitutional amendment should not have the effect of removing all say over electricity reticulation matters from municipalities. Rather, the focus of any amendment should be to place appropriate and distinct powers in national and municipal hands respectively, as outlined earlier.
- * EDI Holdings can propose draft amending legislation to this effect.

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EDI Holdings' recommended approach (...4)



- * In the event that constitutional change is not feasible, a definition of reticulation based on a distinction between *distribution* and *trading* activities may hold some promise of achieving government's policy objectives for the sector. However, the following caveats apply:-
 - The *consequences* of any such definition for EDI restructuring and governance should be fully quantified and understood;
 - Any new legislation should deal with *regulation, restructuring and other governance matters in a complimentary manner*, and
 - The legislation should *distinguish between local and national forms of authority*.
- * EDI Holding's recommends the following proposed alternative definition for reticulation:
"Reticulation" means trading to community customers.

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PROVISIONS GOVERNING PROVINCIAL AND NATIONAL GOVERNMENT INTERVENTION

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Provisions governing provincial and national government intervention

- * The Bill contains a series of provisions (the proposed new **sections 37 to 41**) which regulate intervention, and similar steps, by national and provincial government over municipalities in regard to electricity reticulation.
- * EDI Holdings has certain comments and concerns relating to the proposed intervention provisions. Overall, the provisions –
 - in some respects duplicate provisions already contained in the Constitution, the Structures Act and the Systems Act (and are therefore superfluous); and
 - in other respects conflict with provisions contained in the Constitution, the Structures Act and the Systems Act (and are therefore unconstitutional or lead to an industry-specific and fragmented scheme of intervention). Such provisions include the proposed **sections 39 and 41**.
- * Any intervention scheme contained in the Bill must be consistent with the constitutional scheme. The Constitution contains provisions which acknowledge the need for intervention and oversight powers.

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PROPOSED EDI RESTRUCTURING LEGISLATION

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Proposed EDI Restructuring legislation

- * EDI restructuring legislation should deal with at least the following matters:
 - the establishment of REDs and the transfer by Eskom and Municipalities of their employees and distribution and reticulation businesses into REDs;
 - the manner in which municipalities and Eskom are obliged to ringfence their businesses before transferring them to REDs;
 - the manner in which municipalities and Eskom are obliged to prepare inventories of assets and liabilities;
 - the manner in which municipalities and Eskom are obliged to report to EDI Holdings in relation to their transfers and their restructuring activities;
 - the ownership, governance and reporting requirements of REDs;
 - streamlining the existing legislation governing the EDI (including, where relevant, the local government legislation, including the Systems Act and the MFMA);
 - the conditions in which a RED may be wound up;
 - the resolution of disputes between municipalities, REDs and Eskom; and
 - practical transfer matters (such as those transfers which require the Registrar of Deeds to make entries in and to endorse Deeds Office records in relation to immovable property and rights in immovable property, exemptions from the payment of, for example, transfer duty, the transfer of servitudes as wayleaves, and so on).

- * It is proposed that any gaps that may arise relating to structural aspects of the Industry, be addressed in the EDI restructuring legislation

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CONCLUSIONS

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Conclusions

- * EDI Holdings strongly supports efficient, effective and consistent regulation of the entire ESI.
- * Any amendment of the Electricity Regulation Act should empower the Minister of Minerals and Energy to delegate certain key intervention powers and functions to Nersa, following due process.
- * In the absence of being able to achieve a single economic regulator of tariffs, the Bill should provide that NERSA be empowered to set a national tariff framework to amongst others, achieve tariff rationalisation.
- * Government's initiative to define the extent of municipal authority over electricity matters is strongly supported. This is an essential step to enable the establishment of REDs and other EDI reforms.
- * Economic regulation of a large, integrated national system such as the EDI should be conducted by a professional independent regulator reporting to central government, rather than by hundreds of municipalities.

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RECOMMENDATIONS

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Recommendations

- ✧ The ideal definition of reticulation should distinguish between the *forms of authority* which each sphere of government should exercise over the EDI. EDI Holdings *recommends* that the Constitution be amended to define which forms of authority over the EDI should be allocated to the national and local spheres of government.
- ✧ In the event that constitutional change is not feasible, EDI Holdings *recommends* that a definition of reticulation be considered which allocates responsibility for *distribution* functions to national government and responsibility for (some) *trading* functions to local government.
 - EDI Holding's recommends the following proposed alternative definition for reticulation:
"Reticulation" means trading to community customers.
- ✧ No matter which approach is adopted to define reticulation, EDI Holdings *recommends* that:
 - The *consequences* of any such definition for EDI restructuring and governance should be fully quantified and understood;
 - Any new legislation should deal with regulation, restructuring and other governance matters in a complimentary manner; and
 - The legislation should distinguish between local and national *forms of authority* over the EDI.

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THANK YOU



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