



# Portfolio Committee on Energy

31 May 2011

## The Electricity Distribution Industry: from a municipal perspective



- In 2009 LG at a SALGA NMA took a decision to recommit to the restructuring of the electricity distribution industry in order to address the following challenges among others:
  - Misalignment between the EDI and the current architecture of the local government fiscal framework (very important, from a local government perspective)
  - High inefficiency of the industry owing to fragmentation
  - Inability to leverage economies of scale in respect of investing in assets, sharing of facilities, services, people development
  - Inequitable treatment of consumers across the country



- In terms of the current architecture of the local government fiscal framework, municipalities are expected to primarily rely on local revenue (property rates and service charges linked to their tradable services functions) in order to finance the performance of their constitutional mandate.
- Electricity distribution income and property rates are currently the key sources of local revenue for municipalities – water services and solid waste management services operated at break-even or deficit)
- Electricity distribution income is a key contributor to municipal revenue without which municipalities will not be able to meet their obligations.



- A significant portion of EDI income accrues to a national entity, Eskom, from which local government draws no financial benefit.
- Eskom services key industrial customers as well as households and businesses in the medium and smaller size municipalities that are not licensed to be distributors.
- Smaller and medium size municipalities do not get any financial benefit from EDI in the areas of where Eskom is providing distribution services.

# Restructuring of the EDI sector



- Income from the provision services to key industrial customers does not accrue to local government at all.
- This undermines the current architecture of the local government fiscal framework and contributes to financial viability challenges of some municipalities
- Municipality are not able to exercise the function of being the service authority over Eskom – they are not able to set service delivery expectations or determine investment priorities in their areas (typically leading to disarticulations between IDPs and Eskom Infrastructure investment
- Eskom refuses to sign SLAs with municipalities where it is a distributor. It sees itself as a service authority in its own right, only accountable to NERSA and not municipalities
- This constitutes a critical element of the problem statement that SALGA believed needed to be resolved as part of the EDIR process.
- This and other elements of the EDI restructuring issues remain unresolved



- During the long period of uncertainty regarding future ownership of distribution assets there has been a significant underinvestment in infrastructure
- This added to inherited maintenance backlogs that also accumulated as a result of the country prioritization of extension of infrastructure to the unserved rather than focusing on maintaining infrastructure that served a minority
- Study done by EDIH in 2008 estimated that the backlog was R27billion growing at R2,5 billion per annum
- There is a need for SALGA, DoE and NT to work together to develop a strategy to address this challenge as part of developing a way forward in respect of creating a sustainable industry



- The various consecutive high Eskom electricity price increases have given rise to a debate about protection of the poor against high electricity cost
- In February 2010 NERSA required that Eskom rolls out IBT to conventionally metered domestic customers and later required the same for all domestic customers (conventional and prepaid meters) supplied by Eskom and municipalities
- The NERSA approach to the implementation of IBTs has raised problems in the industry.



- While NERSA is commended on its efforts to provide relief for the low usage customers, unfortunately there are many shortcomings with its IBT version. E.g.
  - Eskom data was used to develop a national tariff structure. This data is not relevant to individual municipalities and also does not adequately segment residential customers. The basis of a good tariff design is to use the customer data of the particular utility.



- The NERSA IBT structure removed the previous capacity related signals included in existing tariffs.
- The IBT structure introduced a revenue risk by removing fixed charges
- Many non-poor customers will benefit from the tariff structure
- It does not take into account regulatory and EPP requirements regarding higher consumption customers paying fixed charges and time-of use rates.



- The basis for determining the blocks, the rates and the increases to the rates appears arbitrary and difficult to justify on a national scale.
- The structure is based on REDs areas rather than income distribution characteristics of consumers in groupings of comparable municipalities
- The NERSA forced IBT application by Eskom on its conventionally metered customers has had a massive negative financial implication.
- This has caused the tariff to the rest of Eskom's customer base to increase by a **further 4.6%** over and above the average increase granted by NERSA.



- When Eskom applies the NERSA IBT it can hedge the impact on the non-domestic customers despite the fact that this impact is unsustainable.
- The impact on municipalities, even more so for the smaller ones, is just not viable.
- Typical results from the application of the NERSA IBT for municipalities are as follows:
  - Loss of domestic revenue: about 25%.
  - Loss as percentage of total revenue: about 10%
  - Loss as a percentage of non-domestic revenue: about 25%



- Despite various efforts by Eskom, SALGA and its member municipalities, NERSA has not been positive in entertaining any debate about alternatives to its version of IBT
- SALGA will, during 2011/12, continue to engage NERSA regarding the principles, design and implementation of IBT
- It will also support of individual municipalities that have applied for a deviation from the NERSA benchmarks



- LG experiences huge revenue loss due to electricity theft.
  - E.g. in the last year the Cities of Cape Town and Joburg lost about R121 million R250 million worth of electricity due to illegal connections respectively.
- The impact of electricity theft is devastating for smaller distributing municipalities.
- Unfortunately despite its impact (financial, economic, loss of life, sustainability, quality and stability of electricity supply and future economic growth) electricity theft is still perceived as a minor offence
- In October 2010, SALGA partnered with Eskom, PRIMEDIA, Proudly SA, BUSA, Business Against Crime and Crime Line to launch of Operation Khanyisa (An anti electricity theft campaign aimed raising awareness about the criminal nature of this act establish mechanisms for the public to report and distributors to act on these reports).
- During 2011/12, SALGA will, with support from Eskom, strengthen its coordination of this campaign among municipalities



- The Integrated National Electrification Program is implemented through Eskom (where Eskom is a distributor) and municipalities in their areas of distribution
- There are cases where municipalities implement INEP projects in Eskom areas of distribution
- The electrification program is also an important means of curbing illegal connections
- It has come to the attention of SALGA that some municipalities are slow in spending their INEP allocations
- There are also cases where municipalities do not have qualified electricity managers and depend entirely on self-interested consultants to apply and secure funding from INEP and MIG – no review of the appropriateness of proposed investments and quality of works – need some centralized capacity to provide technical support to undercapacitated municipalities



- In SALGA's view, all the above matters constitute elements of the EDI structural deficiencies
- In 2010 at a SALGA NMA Local government noted that, LG as a sphere of government whose performance of the Electricity Distribution function and whose revenues depends on the success of the service providers, have the most to lose if the outcome of the EDIR process was:
  - unviable electricity distribution service providers (the REDs at the time); or
  - Viable electricity distribution service providers but severely compromised municipalities
- And committed that local government should therefore play a leading role in shaping this outcome.



- On the 8<sup>th</sup> of December 2010 Cabinet took a decision to discontinue EDI restructuring
- At the time of this decision:
  - 154 of the 175 municipalities licensed to distribute electricity had signed the accession to the co-operative agreement
  - 56 ring fenced electricity business
- But LG had identified 25 key deal issues that needed to be resolved towards the restructuring of the industry
- SALGA has not been favoured with the reasons for the Cabinet decision
- However, during 2011/12 SALGA wishes to partner with DoE in facilitating a session of LG and energy practitioners and leaders to propose a way forward in respect of creating a sustainable EDI

# Energy efficiency program



- With support from SDC, SALGA is facilitating the implementation of the Energy Efficiency Program in Local government starting with 5 pilot municipalities that are considered secondary regional of economic development after the major cities (these are Rustenburg, Mbombela, Sol Plaatje, King Sabata Dalindyebo, Polokwane)
- This is both a climate change mitigation project and a response to the infrastructure capacity constraints in these municipalities.
- Implemented in collaboration with DoE, to achieve effective national, provincial and local government policy frameworks and tools for implementing and monitoring energy efficiency in particular the building sector
- During 2011/12 SALGA will complete the State of Energy reports in the affected municipalities and thereafter facilitate the development of Energy Efficiency Strategies, and business plans for specific projects.
- The projects may include solar water heating projects

# Proposed priorities for the sector



1. Research alternatives to the establishment of REDs as national government entities and convene a session of LG and energy practitioners and leaders to propose a way forward in respect of creating a sustainable EDI
  - That agenda should, among others, deal with issues such as:
    - Structural efficiencies
    - Financing the backlog and future investment needs
    - Pricing
    - In areas such as Free State municipalities are exploring possibilities of establishing a province-wide municipal owned electricity services delivery vehicle –debates need to take into account issues of viability as well as ongoing debates about the future role of provinces and therefore the significance of provincial boundaries as development planning and management spaces
2. Upscaling of the energy efficiency programmer and investment in alternative energy as a substitute to coal based energy in areas such as water heating
3. Intensification of the fight against electricity theft



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# Thank You