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Joint Public Hearings on the Electricity Distribution Industry (EDI)

*Portfolio Committee on Energy
and
Portfolio Committee
Cooperative Governance and Traditional Affairs*

27 July 2012

Presentation content

- SALGA invited to make inputs on the following:
 1. The dual regulatory system between NERSA and Municipalities on supply and distribution of electricity
 2. The electricity distribution industry
 3. Rehabilitation of the electricity infrastructure

Duality of regulation

- There is duality of regulation – authority (legislation and institutions) in respect of:
 1. Deciding service delivery institutional arrangements
 2. Prices and tariff regulation

Deciding on service delivery institutional arrangements

- The Electricity Regulation Act, *inter alia*, establishes a national regulatory framework for the electricity supply industry.
- In this regard, the Electricity Regulation Act regulates generation, transmission, distribution, reticulation (by municipalities), trading and the import and export of electricity.
- The Electricity Regulation Act was amended by the Electricity Regulation Amendment Act, [No. 28 of 2007](#) in terms of which a definition of “reticulation” was inserted as follows:

”reticulation” means trading or distribution of electricity and includes services associated therewith;”



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Deciding on service delivery institutional arrangements

- In terms of the Electricity Regulation Act, a distribution license and a trading license are required for the distribution and sale of electricity to end-users.
- Therefore electricity distributors (Eskom, private sector, municipal entities and municipalities) require distribution and trading licences in order to deliver electricity to consumers (i.e. to be municipal service providers of electricity distribution in terms of the Systems Act).



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- In terms of Section 156 of the Constitution, a municipality has executive authority in respect of, and has the right to administer *the local government matters listed in Part B of Schedule 4 and Part B of Schedule 5.*
- *Electricity reticulation is listed in Part B of Schedule 4*
- Section 76 of the Systems Act states that a municipality may provide a municipal service in its area or a part of its area through an internal mechanism, which may be-
 - (i) A department or other administrative unit within its administration;
 - (ii) Any business unit devised by the municipality, provided it operates within the municipality's administration and under the control of the council in accordance with operational and performance criteria determined by the council; or
 - (iii) Any other component of its administration; or



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- Or an external mechanism by entering into a **service delivery agreement** with-
 - (i) A municipal entity;
 - (ii) Another municipality;
 - (iii) An organ of state, including
 - (a) A **licensed service provider** registered or recognized in terms of national legislation; and
 - (b) A community based organisation or other non-governmental organisation legally competent to enter into such an agreement, or
 - (iv) Any other institution, entity or person legally competent to operate a business activity
- Therefore differentiates between a **service authority** and a **service provider**



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Deciding on service delivery institutional arrangements

- Section 78 of the Municipal Systems Act outlines a criteria and process for deciding on institutional mechanisms to provide municipal services
- In the case of the electricity distribution sector, most municipalities inherited Eskom as a distributor (not decided i.t.o. a Section 78 process)
- NERSA simply issues a distributor license (e.g. Eskom a license to distribute in a given area) without a Municipal Council Section 78 decision regarding service delivery mechanisms in the municipal area or entering into an SDA with the municipality
- This means that NERSA usurps the powers of municipal councils of taking Section 78 decisions and violates the Systems Act criteria and process (this is the first area of dual regulation; regulation of who will provide a service)



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- This has led to unfair treatment of municipalities in areas where Eskom is a distributor
- There are no service delivery agreements between Eskom (as a service provider) and municipalities as service authorities i.t.o. the constitution
- This results in a situation where:
 - The governance authority of municipalities is rendered ineffective in these areas
 - municipalities are not able to use electricity as a credit control measure in such areas
 - Despite the fact that the fiscal framework of local government makes service charges (in particular electricity revenues) a key source of funding for municipalities, in areas where Eskom is a distributor municipalities do not get any income from electricity distribution



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- **SALGA recommends that** parliament must ensure that:
 - All external mechanism services providers of municipal basic services must be decided through a Systems Act Section 78 process and must enter into service delivery agreements with municipalities as required by the Act
 - In the case of electricity distribution the SDA must include:
 - use of electricity supply as a credit control measure; and
 - implementation of a revenue surcharge (as provided for in the Municipal Fiscal Powers and Functions Act)

Recommendations - Electricity Distribution

- NERSA must make concluding an SDA with a municipality, where Eskom is a distributor, a licence condition and disconnecting electricity as a means of credit control must be included in SDAs between Eskom and municipalities
- The Minister of Finance must prescribe the compulsory national norms and standards for imposing municipal surcharges, as required in terms of 8. (1) of the Municipal Fiscal Powers and Functions Act, 2007 in order to enable municipalities to charge a surcharge on electricity supply where Eskom is a distributor.

Prices and tariff regulation

- I.t.o. the Electricity Regulation Act, NERSA has the general power to regulate prices and tariffs (charged by licensees)
- In addition, NERSA is empowered to make any licence it issues to be subject to a number of conditions, including conditions relating to the setting and approval (by NERSA) of prices, charges, rates and tariffs which must be imposed by licensees (section 14(1)(d) read with section 15(2) of the Electricity Regulation Act).
- Section 24(2)(c)(ii) of the Municipal Finance Management Act refers to the “setting” of municipal tariffs generally by municipalities.
- Section 75A(1) of the Municipal System Act states that a municipality may levy and recover fees, charges or tariffs in respect of any function or service of the municipality.

Prices and tariff regulation

- Accordingly, there appears to be an overlap in the provisions of the Electricity Regulation Act and the Municipal Finance Management Act (read with the provisions of the Municipal Systems Act) in that both Acts deal with the imposition of tariffs, albeit the Electricity Regulation Act deals specifically with tariffs charged by its licensees, whilst the Municipal Finance Management Act deals generally with municipal tariffs.
- This is the second area of dual regulation; regulation of electricity supply service prices

Prices and tariff regulation

- While the two legislations seem to clash, SALGA chooses an interpretation that gives full force and effect to each, rather than an interpretation which will partly destroy the effect of one of them
- It accepts that NERSA determines the tariffs while Municipalities, on the other hand, must “set” (or, in the case of the Municipal Systems Act, “levy”) tariffs i.e. “impose” and not necessarily determine tariffs.
- In this interpretation municipalities “set” or “levy” a tariff which was “determined” by NERSA

Prices and tariff regulation

- For this to be possible, the NERSA processes should be organised in such a way that NERSA determines tariffs that
 - do not undermine the financial viability of municipalities;
 - and
 - the timing is such that the determination is done on time to allow municipalities to comply with local government legislation in respect of tariff setting
- Unfortunately, this has not been the case as NERSA does not seem to be sensitive to these matters in terms of its process and content of its annual "tariff guidelines"

Prices and tariff regulation

- **SALGA recommends that** parliament must ensure that:
- The NERSA process adheres to the legislated municipal budgeting processes
- The price determinations are informed by the municipal financial viability considerations and are differentiated according to consumers mix of various municipal areas



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Views of SALGA on Electricity Distribution Industry

Background

- While still functional, the industry is characterized by:
 - High inefficiency 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
 - Inequitable treatment of municipalities i.r.o areas where Eskom is a distributor and where municipalities are distributors (revenue and governance authority)
 - Network outages as a result of distribution failures are on the increase - Average age of assets 45 years.

Background

- Maintenance, refurbishment and strengthening backlog in the EDI (Eskom and Municipalities) was estimated to be at a total of about **R32 bil** and growing at an alarming rate of **R2.5 bil** per annum (Eskom funded to address its backlogs but municipalities not).
- Infrastructure inability to support growth initiatives and national projects such as electrification, security of supply, demand side management etc.
- Critical vacancy rate of about **50%** at electricity departments of municipalities; recruitment, training and retention of skills are a significant EDI sustainability risks.
- Critical electricity skills are close to retirement age – about 25%
- Tariffs differentiation between municipalities and Eskom.
- Theft of copper and electricity exacerbate the problem.
- Leakage of Free Basic Electricity to non-qualifying households.
- Negative effect of tariff increase on poor consumers.

Factors affecting the state of EDI

- The EDI is negatively affected by the following:
 1. Historical factors
 - a) The condition of infrastructure and levels of access to services
 - b) The overall inefficient structure of the industry
 2. The fiscal framework of local government
 3. Unfavourable environment in respect of pricing policy and skills development

Remedial attempts

- **REDS**
 - Cabinet established EDIH in March 2003 to facilitate the restructuring of the electricity distribution into six regional electricity distributors (REDS).
 - Only one RED was established (based in Cape Town) and it later collapsed.
 - Once the key issues that needed to be resolved before implementation of REDs became clear, it became apparent that viable REDs **and** viable municipalities were was not achievable
 - Cabinet subsequently took a decision to discontinue the process of creating the REDs and mandated the DoE to review the whole electricity value chain and address the challenges.
- DoE initiating the implementation of **ADAM** phase 2 - no funding close what is required yet!

Remedial attempts

- In response to increasing electricity prices NERSA introduced **IBTs** as a means of providing relief to poor low usage customers
- Unfortunately there were many shortcomings with NERSA IBT version

Remedial attempts

- LG experiences huge revenue loss due to electricity theft
- Unfortunately despite its impact electricity theft is still perceived as a minor offence
- SALGA is part of a partnership led by Eskom including PRIMEDIA, Proudly SA, BUSA, Business Against Crime and Crime Line implementing **Operation Khanyisa** (An anti electricity theft campaign)
- Electrification
 - Access to electricity currently stands above 83%
 - About three quarters of the remaining is in rural areas
 - In these areas Eskom is a licensed distributor but **non-licensed municipalities implement projects** in these Eskom areas of supply.

Recommendations - Electricity Distribution

- **SALGA recommends that**
 - The DoE should lead a process of developing an alternative approach (to the REDs) to resolve the structural issues facing the electricity distribution industry.
 - The implementation of ADAM Phase 2 be supported but there must be funding to address the challenge of the refurbishment backlog
 - NERSA should review the principles, design and implementation of IBT with the aim of having a more viable and yet pro-poor tariff structures.
 - Coordination of municipal participation in the anti-electricity theft campaign should be improved

Recommendations - Electricity Distribution

- SALGA commits to coordinate and support municipalities to
 - Act and report their actions against electricity theft.
 - Review their bylaws to have more stringent penalties against electricity theft



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Views of SALGA on rehabilitation of the electricity infrastructure

The state of infrastructure

- On establishment municipalities inherited old infrastructure some of which was already overdue for replacement
- In a sense municipalities inherited a liability rather an asset as they also inherited a responsibility of replacing and refurbishing old infrastructure
- This infrastructure had been servicing a minority of the population largely defined along racial lines with the majority population not having access to services.
- The new democratic government decided to rather prioritize extension of services to the un-serviced
- Rehabilitation of this old infrastructure should not and cannot be left to municipalities alone
- A related challenge is lack of data regarding the state of infrastructure.

Recommendation: The state of infrastructure

- SALGA recommends the
 - Establishment of a national municipal infrastructure refurbishment fund that will provide for the rehabilitation of municipal infrastructure at the required scale (This fund should be used to leverage private sector investment).
 - Establishment of national GIS based databases and national programmes to collect data and manage information on an ongoing basis on the state of infrastructure and use this to coordinate acquisition of components



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THANK YOU