

Overview of the Regulatory Environment Regarding The Electricity Distribution Industry in South Africa



**Presentation to Parliamentary Portfolio Committee on Energy
12 September 2017**

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Who is NERSA

- ❑ The **National Energy Regulator** (NERSA) is a regulatory authority established as a juristic person in terms of Section 3 of the National Energy Regulator Act, 2004 (Act No. 40 of 2004) [NERSA ACT]

- ❑ NERSA's mandate is derived from three (3) underlying statutes:
 - **ELECTRICITY** - Electricity Regulation Act, 2006 (Act No. 4 of 2006) [ERA]

 - **PIPED-GAS** - Gas Act, 2001 (Act No. 48 of 2001)

 - **PETROLEUM INFRASTRUCTURE** - Petroleum Pipelines Act, 2003 (Act No. 60 of 2003)

Who is NERSA (Cont.)

- Established 1 October 2005 by the NERSA Act.
 - Decisions based on reasons, facts and evidence
 - Means regulator depends on credible information
 - Public meetings
 - Many opinions obtained from valuable and knowledgeable experts and end-users of regulated services
- Consists of nine members
 - 5 part-time members, 1 designated as a chairperson and another as deputy chairperson;
 - 4 full-time members, one designated as the Chief Executive Officer (CEO)
 - The other 3 designated as full-time members primarily responsible for each of the 3 regulated industries.

Regulatory Principles

Regulatory principles, which guides the Regulator's conduct and service delivery:

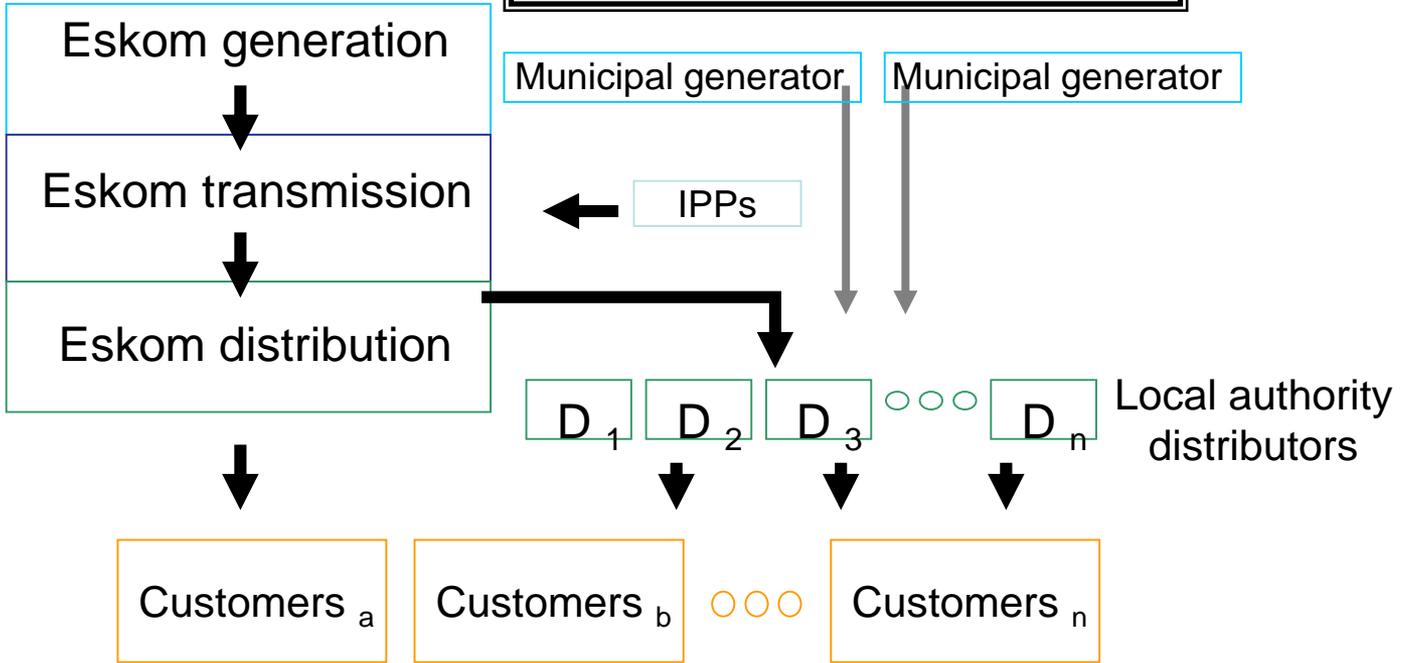
- **Rule of Law:** Law applies to everybody and provides a clear framework for everyone to operate. Review and appeal by high court
- **Transparency:** Reason for decisions and consultative processes;
- **Neutrality:** Neutral to all market players without favouring one or other groups (non-discrimination)
- **Consistency:** Explained decisions enabling stakeholders to take informed decisions – no surprises; predictability
- **Independence:** Independence from stakeholders and politicians; within legal framework and published Government policy)
- **Accountability:** Internal accountability – Regulator takes responsibility for actions and decisions.

Powers and duties of Energy Regulator

Section 4 of the ERA outlines the mandate of the Regulator as follows:

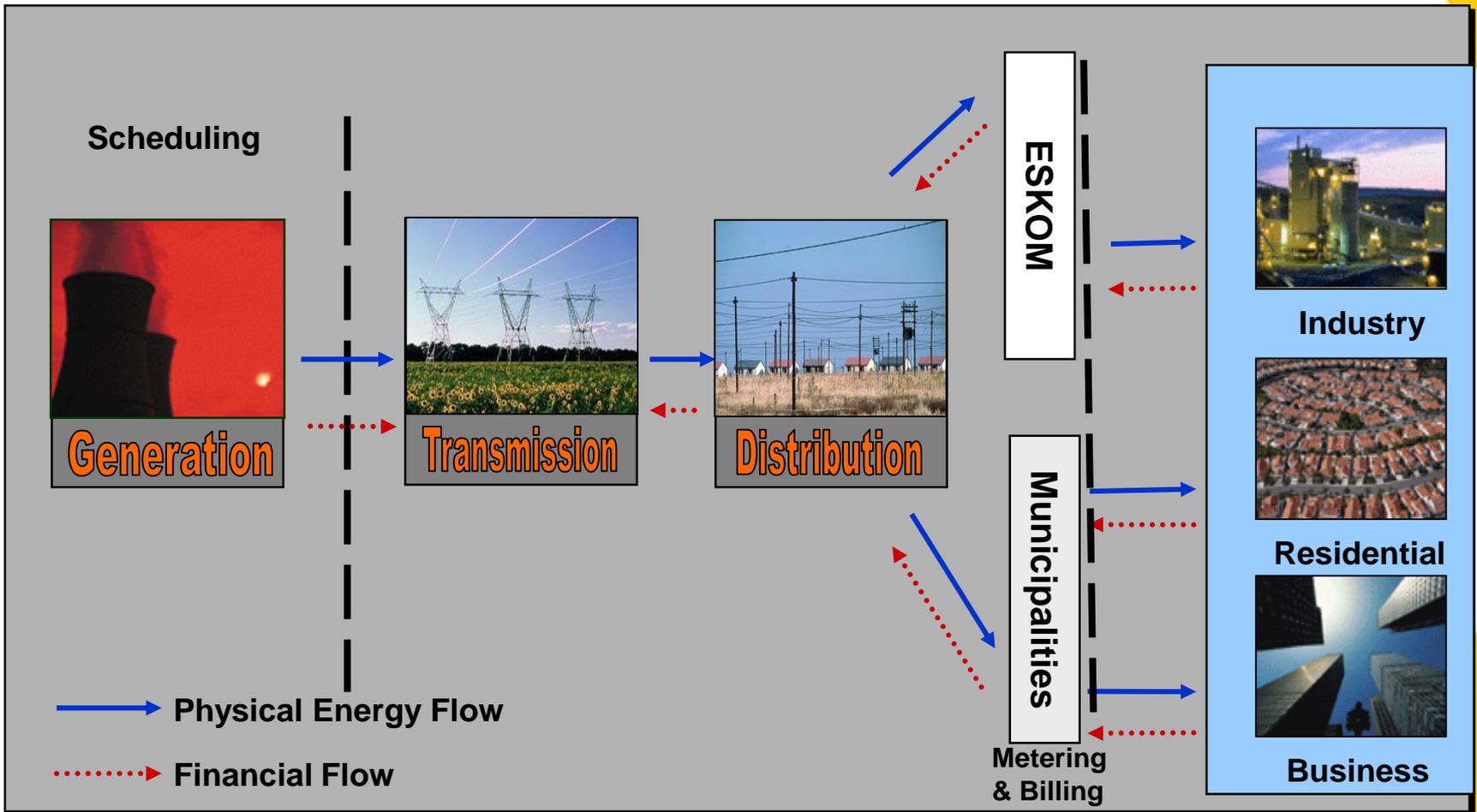
- Licence and/or register Generators, Distributors (including Municipalities), Traders and Importers and Exporters
- Regulate Prices and tariffs
- Monitor Compliance with Licence conditions
- Issue rules designed to implement the national government's Electricity Policy Framework, the Integrated Resource Plan and the ERA
- Establish and manage monitoring and information systems
- Enforce performance and compliance
- Mediate disputes, may arbitrate between a licensee and a consumer
- Undertake investigations

Structure of the ESI



Transmission monopoly
Distribution fragmentation

VALUE CHAIN IN THE ELECTRICITY SUPPLY INDUSTRY



MUNICIPAL TARIFF APPLICATION PROCESS

NERSA Municipal tariff approval process

- Currently municipal tariffs are approved on an annual basis and upon application by the licensees
- The process involves 177 municipal and 10 private distributors
- The process is required to be finalised by 15 March of every year prior to implementation on 1 July of that year (MFMA) – unless an extension is granted by the Minister of Finance
- The process is dependent on the approved Eskom %price increase resulting from the Multi-year Price Determination (MYPD) process
 - NERSA approves the Eskom’s allowed revenues and resultant %price increase applicable to municipalities
 - This is followed by Municipal guideline increase and benchmarks (based on generic assumptions from a sample of municipalities)
 - Licensees apply to NERSA for approval of their tariffs – this must be supported by information pertinent to the individual municipality – from D-forms
 - NERSA reviews the applications and makes a determination on each application

Municipal guideline INCREASE and benchmarks

- The municipal guideline increase and benchmarks are based on benchmarked municipal expenses together with expectations on other economic indicators such as inflation and National Treasury budget guideline salary increases.
- The expenses include:
 - Bulk purchases from Eskom
 - Reasonable energy losses
 - Repairs and maintenance
 - Capital charges
 - Salaries and wages
- For the current financial year the guideline increase is 1.88% and it is based on Eskom's 0.3% increase for local authority electricity distributors

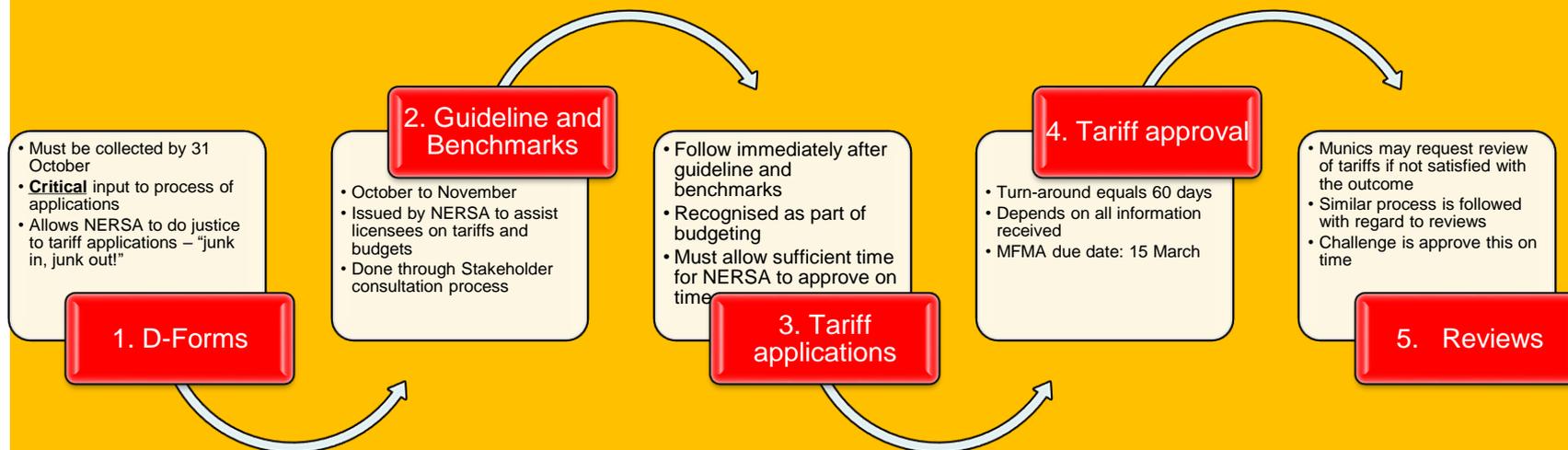
Municipal guideline INCREASE and benchmarks

- The guideline is meant to assist municipalities in preparing their tariff applications – licensees are therefore expected to provide NERSA with quality information that supports their applications
- The Guideline increase is not a final determination
 - Licensees must still apply
 - On reviewing applications, NERSA considers
 - The current municipal tariff structure and levels
 - The tariffs in comparison to NERSA approved benchmarks
 - The efficiency of municipal operations (technical and financial benchmarking)
 - The level of cross-subsidisation
 - Any programmes that the municipalities may be involved in (infrastructure etc.)

SOURCE OF INFORMATION

- All licensed electricity distributors are required to submit Distribution Forms (D-forms) by 31 October every year.
- The in the D-forms contain:
 - Income statement
 - Balance sheet
 - Human Resources information
 - Technical information
 - Tariff information
 - Market information
- The information is used to assess the applications
- All approved tariffs are posted o the NERSA website www.nersa.org.za

TARIFF APPROVAL PROCESS



Challenges 1

- The MFMA requirement is that tariffs must be approved by 15 March in order for such tariffs to be implemented on 1 July of that year, however, it is difficult to meet this deadline if:
 - Eskom's revenue application is late
 - Municipalities apply late – the bulk of the applications are always received after April.
- Some municipalities submit their D-forms late and even if it's in time the integrity of the information is questionable.
- Inaccuracy in the submitted information delays the review process as analysts have to keep on demanding more information and clarity on some issues.
- High staff turnover and lack of requisite technical and financial skills which results in:
 - Inappropriate tariff design → High Notified Maximum Demand (NMD) Charges → High Eskom debt
 - High technical losses from faulty or non existent meters, or poorly maintained network.
- Some municipalities believe that they are obliged to charge tariffs approved by the Council in the budget.

Challenges 2

In an endeavour to mitigate these challenges NERSA:

- embarks on country-wide road shows to conduct workshops to assist municipalities with completion of D-forms in preparation for tariff applications (from August of previous year through to March of subsequent year)
- Seeks to ensure that Eskom's revenue determination is done in time so that the Guideline increase and Benchmarks are finalised by November/December.
- Conducts audits to ensure that all municipal distributors operate efficiently and that the quality of supply and Quality of service are not compromised.
- The 12 analysts are relieved of other duties so that they can dedicate more than 90% of their time on the review of tariff increase applications.

PERFORMANCE MONITORING AND ENFORCEMENT

MANDATE

The Mandate of NERSA derived from the Electricity Regulation Act, 2006 (Act No. 4 of 2006)

- **Licensing:** To issue, amend, transfer, rectify or review licences for Generation, Transmission, Distribution, Trading, Import and Export of electricity
- **Compliance Monitoring:** Ensure and monitor compliance with regulatory requirements, e.g. licence conditions

LICENSING

- According to section 7 of the ERA all electricity distributors are required to be licensed
- Attached to the licence are licence conditions covering:
 - Need to comply with a number of standards: e.g. Quality of Supply, Quality of Service
 - Must maintain ring fenced accounts for the electricity business
 - Must prepare and adhere to plans e.g. maintenance schedules and master plan
 - Provide information to NERSA e.g. annual D forms submission
- Most applications received are for:
 - Amendments of licence areas
 - Merging of licence areas pursuant to Demarcation Board decisions
 - Swopping of licence areas in order have contiguous areas
 - Transfer of some private distribution licences to local authorities.

COMPLIANCE MONITORING

To ensure that licensees comply with regulatory requirements NERSA conducts audits on an annual basis.

COMPLIANCE AUDITS

- NERSA conducts Audits of Distribution Licensees to assess their state of compliance with their licence conditions
- To verify the accuracy of information submitted by the licensee to the Energy Regulator
- To highlight pertinent issues that need to be corrected if any

AUDIT RESOURCES

- The Distribution Compliance Audits are performed by three audit Teams consisting of four people per team.
- NERSA goal is to perform twelve Distribution Compliance Audits Annually.

AUDIT PROCESS 1

Pre Audit Phase

- Compile an Annual Programme
- Initial Telephonic Contact
- Send out Audit Questionnaire and Audit Notification

Audit Phase-Site Visit

- Discuss Responses to questionnaire
- View Documents e.g. Maintenance Plans and Integrated Development Plans
- Check Systems e.g. Financial and IT
- Visit Substations and Inspect Network

AUDIT PROCESS 2.

Post Audit Phase-at NERSA

- Assessment of the information received from the licensee
- Compile a draft audit report
- Forward draft audit report to licensee
- Licensee to forward management comments within 60 days after receipt of draft report
- Licensee must submit corrective action plans to NERSA within 120 days
- NERSA approves the corrective action plans and monitors the implementation of the plans
- Consolidated audit reports can be found on the NERSA website (www.nersa.org.za)

Audits Completed 2017/18

Municipality	Date of audit
Naledi Local Municipality	April 2017
Greater Tzaneen Local Municipality	May 2017
Great Kei Local Municipality	May 2017
Maquassi Hills Local Municipality	June 2017
Kou-Kamma Local Municipality	June 2017
King Sabata Dalindyebo Municipality	June 2017
Ubuntu Local Municipality	August 2017
Nkandla Local Municipality	August 2017
Makana Local Municipality	August 2017
Tsantsabane Local Municipality	September 2017

COMMON CHALLENGES FOR LICENSEES 1

- Electricity business is not ring-fenced
- Insufficient Staff in the Electricity Department
- Lack of asset registers & asset management policies
- Insufficient funds to undertake refurbishment and replacement projects
- Less than 6% of electricity business revenues is spent on maintenance and repairs as required by NERSA

COMMON CHALLENGES FOR LICENSEES 2

- No Master Plans to cater for future load demand
- Network adequacy assessments are not carried out for the current and future demand
- The electrical infrastructure is very old and decaying
- Strategic spares and routine spares are not available

BENEFITS OF COMPLIANCE MONITORING

- Municipality's attention is brought to issues which might have remained unaddressed. This will result in improved compliance in the future.
- Better self monitoring of compliance with licence conditions and industry standards because staff become aware of requirements

ENFORCEMENT

Section 18 of the ERA outlines the procedure that the Regulator has to follow:

1. sitting as a Tribunal the Regulator should first send a notice where they instruct the Licensee to comply within a set period
2. If there is no compliance within that period then Regulator may impose a penalty of 10% of the annual turnover of the licensee or R2m, whichever is the higher, per day commencing on the day of receipt of the notice sent earlier.

CONCLUSION

- Municipalities must change their business model to decrease reliance on Electricity revenues which will be impacted by small scale embedded generation
- Industry performance is hindered by the lack of skilled personnel
- Electricity Infrastructure refurbishment and maintenance backlog is increasing
- The need for Electricity Distribution Industry Reform still exists – too many tariffs and many municipalities are financially and technically unsustainable
- Despite the challenges NERSA is achieving its mandate in the regulation of the Municipalities Electricity Supply industry

Thank you

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