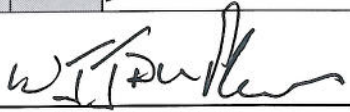





Legal Comments Form

Unique Identifier	216-28
Revision	1
Revision Date	May 2013
Corporate Legal Department	

		COMMENTS DETAILS	
		ACTIONS	COMMENTS
TITLE	Independent System and Market Operator Bill [B9-2012]		
DUE DATE	13 April 2012		
NAME OF THE LEGAL ADVISOR	Vickie Govender		
NAME OF THE CR/ DIVISION	Regulation and Legal		
DATE ASSIGNED	16 March 2012		
TEAM LEADER	Willie du Plessis		
ACCEPTED	x		
NOT ACCEPTED			
TEAM LEADER'S SIGNATURE			
LEGAL ADVISER	Vickie Govender		
LEGAL ADVISOR'S SIGNATURE			
DATE	13 April 2012		
NO COMMENTS	TEAM LEADER		
	ACCEPTED		
	NOT ACCEPTED		
	TEAM LEADER'S SIGNATURE		
	LEGAL ADVISOR		
	LEGAL ADVISOR'S SIGNATURE		
	DATE		


 General Manager: Legal


 Signature


 Date

Mr S.J. Njikelana, MP
Portfolio Committee on Energy

Date:

13 April 2012

Enquiries:

Neli Mokhunoane
Tel: +27 11 800 6140

By email: akotze@parliament.gov.za

Dear Mr. Kotze

Independent System and Market Operator Bill [B9-2012]: Comments

We thank the Portfolio Committee on Energy for granting us the opportunity to comment on the ISMO Bill and provide our comments herewith, as per the enclosed document.

We trust our comments will assist the Committee members in their deliberations of the Bill and we are furthermore prepared to make oral submissions to the Committee on 15 or 16 May 2012.

Kind regards



WJJ du Plessis
GENERAL MANAGER: LEGAL

Confidential and Proprietary to Eskom Holdings Limited

**INDEPENDENT SYSTEM AND
MARKET OPERATOR BILL**

published in
Government Gazette No. 34289 of 13 May 2011

Dated March 2012

COMMENTS BY ESKOM HOLDINGS SOC LIMITED ("Eskom")

DATED 13 APRIL 2012



**COMMENTS BY ESKOM ON
INDEPENDENT SYSTEM AND MARKET OPERATOR BILL (BILL)**

1. INTRODUCTION

- 1.1 Eskom acknowledges that the private sector has an important role to play in contributing to the introduction of future generation capacity in order to strengthen the system adequacy and meet growing power demand, which is intrinsically linked to Eskom's ability to "keep the lights on".
- 1.2 The regulatory framework that supports the introduction of private sector participation is therefore appropriate. It is anticipated that the Bill, once enacted and effective, will provide improved certainty for all participants in the electricity industry with regards to government's intention with regard to the electricity sector. .

2. GENERAL COMMENTS

- 2.1 Clarity of End State: The industry cannot be restructured in a vacuum and this must therefore be done for a particular purpose and towards the attainment of defined goals. It would be therefore be ideal if there was clarity on the end state or vision for the industry before commencing any restructuring.
- 2.2 Phased Approach: To the extent that there is still a lack of clarity regarding the end state of the electricity industry, it is critical that the implementation of the ISMO be done in a phased approach. This would allow a controlled restructuring to the extent necessary while allowing government the opportunity to clarify the long-term vision and end state for the industry. The ISMO should fit into a broader scheme aimed at, for example, enhancing security of supply or promoting competition. Eskom strongly supports the need for a phased implementation of the ISMO with gradual transfer of responsibilities
- 2.3 Nature of Phasing: Eskom has already undertaken initial steps towards the development of the ISMO by ringfencing some of the identified activities within a separate Division. Work has begun with the Department of Public Enterprises towards the establishment of a wholly owned subsidiary within Eskom Enterprises to perform the initial duties of the ISMO. Eskom is planning to second staff and provide resources and support services to the subsidiary. It is expected that at a future point, determined by Government, this subsidiary could become the separate state-owned company as contemplated in the Bill.
- a. It is important that the establishment of the ISMO and the transfer of functions does not affect security of supply during this critical period. Eskom therefore suggests a phased approach based on the achievement of certain milestones before progressing to the next phase.
- b. The first phase should commence with the transfer of the Energy Planning and IPP procurement functions.

- c. Once the financial issues are clarified, this can be followed with the wholesale function.
 - d. System Operator functionality should be transferred only once there is adequate system capacity in order to effectively manage the current capacity shortfall.
 - e. The transfer of customers should be left until the mechanisms are in place to manage cross-subsidies (as indicated below) and the other financial issues (discussed below) are addressed.
4. Financial Sustainability: Once the ISMO is required to enter into long term power purchase agreements with (independent power producers (IPPs)) and Eskom generators as an independent entity, if it has a limited balance sheet and is not properly capitalised, there will be a requirement for long-term state guarantees to ensure the credibility and viability of the procurement process from independent generators. Similarly Eskom's long term credit rating would depend on solid support for its generator sales to the ISMO (especially as a larger percentage of its revenue would become dependent on a single entity). The state would also need to provide liquidity support to the ISMO in the eventuality of a payment default by a customer. The framework to ensure financial sustainability must be clear as soon as the ISMO is established.
- a. The possible loss of key customers and large municipalities will cause a significant revenue loss and change in money flows for Eskom's balance sheet which must be assessed as part of a comprehensive due diligence prior to the transfer of such customers, as it could lead to a credit downgrade of Eskom. Many unguaranteed loans may call for their loans to be guaranteed if the loss of rating results in a downgrade below investment grade. In accordance with existing loan covenants, any material condition which impacts on Eskom's ability to perform its payment obligations to a lender would result in a material adverse effect which would trigger the early repayment of loans. Eskom has a significant debt book of over R180bn. A call to repay loans early would have serious financial consequences for both Eskom and Government. For any reorganisation of Eskom, a detailed implementation plan will have to be presented to Eskom's current creditors for consent before implementation. This may be managed with the necessary transfer provisions encapsulated in the legislation as was done in the Eskom Conversion Act, 13 of 2001.
 - b. Mechanisms need to be instituted to manage cross-subsidies between different customer groups when transferring customers to the ISMO. In particular ISMO customers must continue to contribute to the explicit rural and electrification levies, with mechanisms for the ISMO to transfer these contributions to Eskom. Additional energy-related cross-subsidies are likely to persist resulting in additional mechanisms required to make these explicit and provide mechanisms to transfer the funds between retailers. Section 32 could include such mechanisms.
5. Asset Values: With regard to the transfer values contemplated in section 40(1) (i) it would be useful if objective criteria are provided to guide the decision of the Minister in this regard. For example, a provision that the values will be based on market values. This is important from the perspective of lenders and for Eskom's credit rating.
6. Clarity regarding Customers: The Bill makes provision for the ISMO to sell power not only to Eskom, but also the key industrial customers and large municipalities.
- a. The Bill should clarify whether the old definition of "key industrial customer" will be retained (those with an aggregate consumption of more than 100GWh per annum) or if ISMO will sell only to Transmission-connected customers. It also

needs to be decided which municipal distributors will qualify for wholesale purchases.

- b. A clear definition would be preferable to ensure that customers are unambiguously allocated to ISMO, or Eskom or other licensed Distributors. Ideally it should be clarified whether these customers have the right to choose a supplier or are automatically transferred to (and obliged to buy from) the ISMO.
7. **Contracts:** The increased transactional complexity of transferring customers to the ISMO is a concern, especially with regards separating contracts for energy and for network services. The interaction between these and other contractual requirements needs to be considered, possibly through rules devised by the National Energy Regulator of South Africa (NERSA). It might be preferable for the Bill to provide legal mechanisms under which existing supply contracts with Eskom's customers would be unbundled into energy and network services components and the customers compelled to purchase energy from ISMO.
 8. **Transfer of Employees:** The effect of the formation of the ISMO as outlined in the Bill will result in the automatic application of Section 197 of the Labour Relations Act, 1995 ("the LRA"). Section 197 of the LRA already governs the manner in which employees that are transferred from one entity to another are to be treated. All the sections dealing with the transfer of employees should be deleted and the provisions of the LRA relied on.
 9. **Governance:** The Bill contains elements which are adequately dealt with in the Public Finance Management Act (1999) and the Companies Act (2008). It is recommended that the framework of the Companies Act and the PFMA in these respects is recognised instead of attempting to selectively restate the applicable provisions in the Bill. The Bill should therefore not repeat or deal with these issues.
 - a. In addition, the Bill is overly prescriptive regarding matters that can be adequately addressed in the Memorandum of Incorporation of the ISMO. The Bill contains numerous sections dealing with the ISMO Board that should more efficiently be catered for in the Memorandum of Incorporation of the company rather than at a legislative level (particularly sections 3.3, 5.3 13, 18, 21, 22, 23, and 24). An example of a potential problem of being too prescriptive at the legislative level is evidenced in Section 26(1) where the current drafting constrains the ability of the Board to delegate differently, alternately the question can be posed; are the responsibilities of appointing staff only for the Chief Executive?
 10. **Establishment:** The Bill should also allow flexibility for the ISMO to be established through the takeover by the state of the subsidiary created by Eskom, with appropriate clauses exempting this transfer from any taxes, levies or any other charges. Alternatively, it should provide for the transfer of the subsidiary from Eskom to the company established by the state. At the moment the Bill refers only to the establishment of a company by the state.

3. SPECIFIC COMMENTS

1. Definitions (Section 1): As a general drafting comment, the definitions should be generally reviewed to align with the new Companies Act, Electricity Regulation Act (ERA) and network codes. Further, certain definitions, for example transmission network, which

are defined in other pieces of legislation, should not be defined again but rather cross referenced.

- a. "Ancillary services" are defined with a list of existing services. It is recommended that these should not be listed as they may change in future.
- b. The reference to the Grid Code should refer rather to the "Code" as used in the ERA since "Grid" is commonly used in relation to the Transmission network only.
- c. The definition of "integrated power system" should rather refer to the "national integrated power system" which also includes the distribution system and generators connected to it.
- d. The definition of ISMO customers should preferably be changed to separate suppliers to the ISMO (supplying energy and ancillary services) and customers of the ISMO (those purchasing energy from ISMO), which should also be defined according to some criteria.
- e. The definition of the "national control centre" should be altered to "means the control centre operated and maintained to ensure continuous and reliable operation of the (N)IPS" (in order to avoid limitation of the functions of the control centre)

2. Objects of the Act (Section 2):

- a. Delete "maintenance and" from Section 2(f) since coordination of outage schedules accurately reflects the function and is in line with Section (4)(2)(l).
- b. Dispatch and tariff aggregation should ideally be separated in Section 2(h) (since Section 2(g) mentions dispatch this could be deleted from 2(h));


3. Functions of ISMO (Section 4):

Preferably the Section should have a proviso that all functions are "in accordance with the Grid Code" which would preclude having to say as much in each paragraph. Furthermore it is preferable to define a few categories of functions with a general provision to do all things necessary or required in order to achieve the objects of the Bill. The attempt to provide an exhaustive list is always difficult especially when key functions are inadvertently missed and not specified.

- a. Sec 4(1) (b) should preferably refer to "transmission operators" rather than the "the transmitter" in order to be consistent (especially with 4(2) (m)).
- b. The System Operator does not optimise to reduce losses (as indicated in Section 4(2) (c)) but rather minimises the total cost of meeting electricity demand while maintaining system security; it may be imprudent to make minimising losses a responsibility of the SO.
- c. Change reference to "dispatch schedules" in Section 4(2) (f) to "dispatch rules". There is no "dispatch schedule" in the Code; the schedule is produced by the market operator.
- d. Refer to the SAPP utilities in Section 4(2) (j) rather than "adjacent control areas".
- e. Add "as far as reasonably possible" to the end of Section 4(2)(l) as it is not always possible to ensure sufficient capacity to meet demand is available.
- f. Sections 4(2) (q) and (r) potentially provide too much detail for legislation and are better governed by the Grid Code.

4. ISMO fees tariffs and charges(Section 32)

- a. The powers of ISMO to refuse supply services (under Section 32(2)) should incorporate the authority to instruct the relevant network operator to terminate supply to defaulting customers. Similarly there should be consideration for the



eventuality that a network operator terminates supply to an ISMO customer due to a default on network charges, resulting in ISMO being unable to sell energy as contracted.

5. Transfer of assets, rights, liabilities and obligations (Section 40):

- a. Clarification is required regarding how transferred assets (and shares) will be paid for and what to do with any liabilities attached to these assets, especially as Eskom's balance sheet and debt covenants need to be protected.
- b. For the sake of clarity the Bill should be clear that Eskom would need to be paid for seconded employees. If Eskom simply secondes employees without payment Eskom will be unable to deduct the cost of these employees for tax purposes.
- c. The effect of the formation of the ISMO as outlined in the Bill will result in the automatic application of Section 197 of the Labour Relations Act, 1995 ("the LRA"). Section 197 of the LRA already governs the manner in which employees that are transferred from one entity to another are to be treated. It is clear from those provisions that the legislature's intention is to ensure that, when businesses are transferred as going concerns, affected employees retain their jobs with the new employer irrespective of the wishes of their employers. Eskom is of the view that the LRA provides sufficient protection to employees in the event of a transfer of a business and therefore there is no need to regulate this in the ISMO Bill. In addition, the provisions of the section 197 are very complex and have since their enactment given rise to various legal challenges. Introducing a new section in this Bill to also govern the transfer of employees will not only increase the complexities surrounding transfers, but will have the effect of creating a special law governing the transfer of Eskom employees, independent to other employees in the country. This will result in an increase in the ambit of disputes related to transfer of employees. Eskom proposes all clauses in Section 40 be amended to align with LRA.

4. CONCLUSION

These comments have been developed to provide constructive input regarding a matter that is crucially important not only for the electricity sector but for the entire country.

Please contact Eskom if you require any further information or clarity regarding the matters set out herein.

We would also like to extend our appreciation for the opportunity to provide comment.

DATED THIS 13th DAY OF APRIL 2012



WJJ DU PLESSIS
GENERAL MANAGER (LEGAL)
ESKOM HOLDINGS SOC LIMITED