

New Electricity Regulation Bill Proposes Radical Changes

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A new Electricity Regulation Bill has been introduced into Parliament which, if enacted, will strip the power of the National Energy Regulator (NER) to approve electricity prices for 98% of electricity consumers living in cities and towns in South Africa. Instead, government may hand this power to municipalities acting under the guidance of the Minister of Minerals and Energy. Is this a good idea?

The technical language and complex definitions contained in the Bill have caused many to miss the radical changes that will result if the Bill becomes law. So bear with me as I try to explain the essence of the changes. The Bill picks up on a single line in the Constitution that states that “A municipality has executive authority in respect of, and has the right to administer.....electricity reticulation.” There has always been some debate about what this actually means.

The new Bill chooses an interpretation that maximises the powers of municipalities. Reticulation is defined as the distribution of electricity to domestic, commercial and light industrial customers within municipal boundaries. Critically, the Bill excludes reticulation entities from the requirements of being licensed; thus the regulator will be stripped of powers to set or approve prices for customers of such entities, i.e. for most of us. The Bill also gives municipalities control over service providers, such as Eskom or Regional Electricity Distribution Companies (REDs), operating within municipal boundaries.

The NER has demonstrated the value of effective economic regulation. In 2004, Eskom applied for an 8.5% increase in tariffs – but after careful consideration of Eskom’s costs, the regulator limited the increase to 2.5%. Eskom argued strongly at the time that its financial viability would be undermined. History has subsequently backed the judgement of the regulator: Eskom’s financial statements for 2004 demonstrate that despite lower tariffs, it continues to earn healthy profits. In 2005, the savings achieved by the regulator are even greater. The NER limited percentage tariff increases to single digits after Eskom applied for double digit increases. In the past, the NER has been able to pass these savings on to consumers keeping municipal electricity tariffs in line with the Eskom price increases.

There are at least five major flaws to the Bill. First, there is a fundamental misunderstanding of how economic regulation works. Instead of building on the successful methodologies currently employed by the NER (which follow international best-practice), the bill proposes the development of general guidelines for municipalities. National norms and standards might be appropriate in technical areas such as maintaining

voltage or frequency levels. They may even be used to define which types of tariff structures may be employed. But they are useless for establishing actual tariff *levels* for customers supplied by specific utilities. Economic regulation requires an understanding of operational costs, the asset base, investment plans, cost of capital and revenue requirements of individual utilities and involves setting realistic and effective incentives for efficiency improvements. The NER has been applying these methodologies to Eskom and is planning to use them for large municipalities and the REDs. National guidelines, on the other hand, can only be applied in a general sense and are a weak and ineffective instrument for driving costs down and protecting consumers. This is not a trivial matter: it affects ultimately economic growth prospects and the affordability of electricity for consumers.

Second, it makes no sense to duplicate the functions of the regulator by granting numerous additional regulatory functions to the Minister. The NER has progressively built professional capacity which constitutes a valuable national resource. Involvement by the Minister in prescribing norms and standards confuses regulatory roles and responsibilities and compromises the independence of the regulator. We have seen the costs of these confused and duplicated regulatory roles in the telecommunications sector.

Third, local government and municipalities are not easily able to combine or balance their different functions of political representation (pressures from constituents for free or cheap services), asset ownership and operation (the potential to extract surpluses) and regulation (balancing consumer protection with financial sustainability). Experience shows that municipalities often get the balance wrong. In many areas, electricity assets are being run down, surpluses are being extracted for other purposes and consumers in some areas now face the prospect of rising prices and unreliable service. Independent regulation encourages utilities to get the balance right.

Fourth, there is no reference in the Bill to government's intention to merge all the electricity distribution entities in municipalities and Eskom into six REDs. By far the most elegant and effective regulatory regime would be for the NER to protect the majority of electricity consumers by simply regulating these six entities directly. It would be much easier for each RED to deal with one regulatory authority, the NER, than multiple municipalities.

Fifth, the proposed compliance procedures for municipalities are so cumbersome and elaborate that, at best, they will be ineffective and, at worst, entirely unworkable. The regulator first has to obtain information, then must request compliance with national norms, failing which the Minister must be notified who then has to request the relevant MEC or another Minister (Provincial and Local Government) to intervene and request compliance, and so on.

Why is the current straightforward regulatory regime being replaced by such a complex system with limited potential for success? It is hard to believe that government consciously or unanimously seeks to emasculate the National Energy Regulator which is

widely regarded as one of the more effective infrastructure regulators in South Africa and, indeed, the continent.

It seems as though a small number of bureaucrats have lost sight of the big picture and have developed a narrow interpretation of the Constitution and the Municipal Systems Act without adequately appreciating that consumers and our economy could be negatively affected.

What is to be done? First, the right of the NER to regulate the entire electricity network, including municipal utilities and REDs, needs to be restored. Second, the constitutional rights (“executive authority and administration”) of municipalities over electricity reticulation need to be defined as meaning that they have broad responsibilities around electrification planning and integration with other services, such as housing, but *not* the right to regulate electricity prices.

The first response of municipal authorities may be to welcome the new Bill. However, a more careful analysis of the above arguments might lead to another view. Municipalities do not have to run electricity reticulation services directly. They can exercise their rights through common service delivery agreements with the REDs. They will still be able to secure income from electricity sales through their shareholding in the REDs, and according to formulae in the service delivery agreements. They can help set electrification targets and ensure that the poor receive subsidised basic electricity services. Surely, at the end of the day, municipalities want to ensure that all their constituents receive reliable and affordable supplies. This is best achieved by efficiently run REDs that are professionally regulated. (I also cannot imagine that municipalities relish the thought of multiple regulatory regimes with Ministers and MECs being given new powers to prescribe norms and standards and to enforce compliance. Dealing with one national regulator with an increasing reputation of professionalism, independence and predictability, may be much more preferable).

The electricity system in South Africa comprises a nationally integrated system with a contiguous value chain that flows from generation through transmission and distribution or reticulation. Effective regulation requires a professional national regulator who is able to squeeze efficiencies along the entire value chain and ensure that these are passed on to consumers. Let’s hope that interested and affected stakeholders will make their voices heard in the Parliamentary hearings on this Bill (scheduled in October/November) to ensure that it is substantially amended.

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