Electricity security / Anton Eberhard

Rosier future without the REDs

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While the Western Cape blackouts of last year, and national load-shedding in January this year, provoked deep concern around the security of South Africa's electricity generation, frequent area-specific distribution failures induce irritation and sometimes resignation. Such complacency is dangerous. Cumulatively, these supply interruptions are eroding South Africa's ambition to lift economic growth rates and improve the welfare of its people. The greatest threats to supply security in South Africa in the future may derive, not from inadequate generation capacity, but rather from a deteriorating electricity distribution system.

Recently the National Energy Regulator commissioned independent technical audits of eleven of the largest electricity distributors (nine municipalities and two Eskom regions). These audits paint a disturbing picture of deteriorating supply security amongst municipal distributors (however, some exceptions were also noted, such as eThekwini).

The proximate causes of these failures are inadequate investment in physical and human capital. The electricity distribution networks of smaller municipalities, in particular, were observed to be in a poor state of repair and there are instances where basic contingency requirements are not met. Staff are de-motivated and often under-skilled for the requirements of the job. Very few formal systems are in place for managing maintenance processes or for training and developing new staff.

By contrast, Eskom distribution regions were observed to be performing relatively well. They have competent management and maintenance systems, adequate funding for refurbishment and access to sound technical expertise. However, Eskom accounts for less than half of electricity distribution; municipalities are responsible for supplying the majority of customers.

The audits also noted that the lack of municipal investment was related to the hiatus in government's plans to restructure the electricity distribution industry. The drivers for reform and restructuring were, and still are, inefficient operations, lack of economies of scale and scope through industry fragmentation, financial instability, inequitable and multiple tariffs and ineffective electrification.

Reform of the sector has been discussed seriously since an ANC Electricity Conference in 1992, which for the first time brought all the relevant stakeholders together. Subsequently, the National Electrification Forum was established and, in later years, the Electricity Working Group and the Electricity Restructuring Inter-Departmental Committee. This work culminated in the PWC Restructuring Blueprint Report and a number of Cabinet decisions to amalgamate more than 180 municipal distributors and Eskom's distribution regions into six, adequately-resourced, Regional Electricity Distribution Companies (REDs).

In 2004, government established the EDI Holding Company to implement these mergers. Despite nearly 15 years of talk, studies, Cabinet decisions and the expenditure of more than R100 million, very little progress has been made towards the establishment of the REDs. RED1, which was established on paper in July 2005 in the Western Cape, is to be disbanded after a failure to transfer staff and assets from local utilities.

This author recently interviewed major stakeholders in the sector. With the exception of one government department, all stakeholders privately expressed misgivings about the road map for setting up the REDs and dismay that so many key issues remained unresolved. They also expressed scepticism whether any real progress would be made without dealing with the Constitutional provisions that currently give municipalities sole rights over the reticulation of electricity.

The focus of the Department of Minerals and Energy is now on drafting legislation that will govern the restructuring process. However, legislation takes time and there could be another 18 months delay before key uncertainties are clarified. And without changing the Constitution, the movement of municipal distributors into the new REDs will remain voluntary. Cape Town has announced that it will not participate in a RED.

However, it is not only opposition party-led councils that are opposed to the plan. Most of the metros and many ANC led councils are deeply opposed to losing their electricity distribution businesses, particularly if Eskom will also participate in the REDs. Eskom, itself, is holding back until its future role in the restructuring process is clarified. Given this level of resistance in the industry it is not surprising the EDI restructuring process is going nowhere.

While the voices of those who call for the removal of municipalities' right to reticulate electricity are increasingly been heard, a constitutional amendment remains politically unlikely. Even within the ANC, there are serious differences between national and local government representatives, who argue that it is critical that they maintain a developmental responsibility to provide these services to their people.

How do we break this impasse? It seems obvious to me that any successful restructuring process should be built on at least the following three foundations: first, any restructuring plan should enjoy the genuine endorsement of the majority of stakeholders in the industry such that they become willing and active participants. Second, because Eskom's distribution businesses are performing better than many municipalities, Eskom should play an integral part in the restructuring process. And, third, any restructuring process of this magnitude (in 2004 total electricity distribution sales were R57 billion and combined staff numbers were 27,000) must be undertaken extremely carefully so as not to undermine the security of supply.

So how do we get the support of the majority of the industry? How do we maximise Eskom's involvement? And how do we manage the merger securely?

Twelve of the largest municipalities account for about 80 per cent of electricity distributed by all municipalities. Allowing these large municipalities to retain their electricity businesses – but providing intensive and sustained support for them to develop ring-fenced, corporatised, effectively regulated and well managed utilities, with adequate investment in physical and human capital – will be an important and practical first step.

Second, while Eskom should be required to transfer, on a proportional basis, those networks, staff and systems that serve customers within the boundaries of these twelve large municipalities, Eskom should be allowed to retain the balance of its distribution business: i.e. in rural areas, small towns and to qualifying large customers.

Third, Eskom should be allowed to take over failing electricity businesses from smaller municipalities. These municipalities are, in many instances, not making any money from electricity sales, and attractive financial incentives could be offered for them to transfer their electricity divisions.

Fourth, those medium sized municipalities that are providing a reasonable level of service to their electricity customers (and there are some) should be left alone.

These proposals involve abandoning the REDs model. Politically, a major policy rethink is difficult, as recent decisions by Parliament's Portfolio Committee on Minerals and Energy, as well as Cabinet, to stick with the six REDs model demonstrate.

However, the above proposals have the best chance of winning the support of the most important and powerful service providers (the large municipalities and Eskom) and hence stand the best chance of being implemented successfully. These proposals will also involve the least disruption to the sector, while promoting performance improvements and service delivery. By creating policy certainty, the industry will at last be encouraged to make the necessary investments in maintenance, system strengthening and skilled people to secure electricity supply such that it supports accelerated economic growth and improved welfare for all our people.

Anton Eberhard is a professor at the University of Cape Town's Graduate School of Business. He was a Board member of the National Electricity Regulator and later a Board member of RED1. This is the third in a series of articles published in Business Day that have analysed the root causes of electricity supply failures and the adequacy of measures to restore electricity supply security