

ELECTRICITY REGULATION: THE WAY FORWARD

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Introduction

Ladies and Gentlemen. Thank you for providing me with an opportunity to share some of my thoughts on where electricity regulation is heading against the backdrop of imminent changes in policy, legislation and governance that directly affects the electricity supply industry (EDI). In this brief discussion I will for obvious reasons concentrate on the distribution field. In the process, I would like to recap on the tools that are currently available for the National Electricity Regulator (Regulator) to execute its regulatory mandate, what problems are being experienced in attempting to fulfil its mandate, and finally, how it is foreseen that developments in the EDI would, or could, affect the Regulator.

What tools are available

Without getting too technical, the Regulator has in effect three main tools or mechanisms available to regulate the electricity industry. These are:

- the issuing of licences;
- approving tariffs for licensees, and;
- stipulating information required from licensees.

As far as licences are concerned, currently issued licences in essence repeats the requirements as outlined in the Regulator's enabling legislation, namely: "The Electricity Act of 1987", as amended. With the help of industry officials, technical standards, namely NRS 047 and NRS 048, respectively dealing with customer service and power quality, have been developed and compliance with them are now included as licence conditions. To augment NRS 048, a directive dealing with power quality has also been issued. Although information provision by licensees are entrenched in the legislation

and licences, I will deal with the requirements, issues and problems associated with this aspect after I have dealt with tariff approval.

Let me be frank, the one tool (power) that the Regulator has that causes "pain" to the industry is the tariff approval power. As you are aware, this power has been disputed by licensees on a number of occasions, on one occasion nearly ending up in the Pretoria High Court. However, until changed by legislation or proven unconstitutional, this is the one tool in the arsenal that the Regulator can use to curtail rising electricity prices, rationalise the large number of different tariffs existing, provide incentives to licensees to reduce technical losses, improve quality of supply and electricity distribution networks, etc. Is the regulator using this tool effectively? In short, this is really an essential tool, i.e. THE tool. I will return to this aspect a little later.

Finally, perhaps not a tool in the true sense of the word, but certainly an aid, and a very essential aid at that, available to the Regulator is the requirement for licensees to provide the Regulator with such information as is necessary to effectively regulate the industry. Let me state this categorically, without the right information, at the right time, the Regulator would be flying blind and would not be able to fulfil its obligation to society at large and electricity customers and suppliers specifically. How are we doing on this score? More later.

Problems in current legislation

I do not want to use this opportunity to analyse current legislation with a view to identify perceived shortcomings or omissions. After all, the Regulator does not make national policy or determine the legislative framework within which it wants to operate. However, notwithstanding the foregoing statement, I believe there is an aspect that should be mentioned, namely,

current legislation does entail insufficient punitive provisions. For instance, fines currently extend from a maximum of R200.00 per day for not supplying requested information to a maximum of R1 000.00 or imprisonment for hindering and obstructing persons authorised by the NER from inspecting licensed premises. Hardly sufficient to discourage non-compliance. Deviating for a moment, the new proposed ESI Regulatory Bill does improve this situation markedly and should ease the position in cases where the Regulator finds itself in a position where it has to resort to drastic measures.

Analysis of problems currently being experienced

So against the backdrop of the tools available to the Regulator and shortcomings in current legislation, what problems are being experienced? The answer is fairly simple, namely, the lack of timely provided accurate and relevant information. Currently the Regulator requires licensees to provide returns in the form of Distribution Information Returns, the so called D-forms. These forms provide the Regulator with essential information in order to fulfil its mandate. The information spans financial information, electrical purchases and sales, customer and plant details, tariff information and customer service and quality of power statistical information. The information is used in the tariff approval process, publishing annually the Electricity Supply Statistics and monitoring customer service and power quality. In addition, electrification statistics are required to be submitted to monitor electrification progress and assist with the allocation of electrification funds. Finally, current legislation requires the submission annually of audited financial statements.

Are we on track as far as information is concerned? I believe the answer must be no, although improvements are being recorded. Just have a look at the annual Electricity Supply Statistics publication and see how many licensees have not submitted information at all and in how many cases the information is not all supplies. What, however, is not visible, is the number of returns that require messaging after being checked by validation processes to correct figures submitted, for example in the wrong units. Why, if the form require sales in kWh do

we find that some licensees provide MWh (and even GWh) figures. Similarly, financial figures that should be in R000's, is sometime entered in Rand values or even R millions. I want to assure you that this causes the Regulator a large volume of unnecessary work. It would be so much simpler if the information is properly validated and correctly entered at the source of entry.

Let me provide some facts and figures so that you can get a feel of what I am talking about. As part of the process to pave the way to rationalise tariffs and assist in the approval of tariff applications by licensees, the Regulator regularly analyses submissions of D-forms and tariff applications.

The position at the end of June is depicted in the following table.

Description	Number (%)
Number of municipality entities licensed for distributing electricity	175
Municipal entities that have applied for tariff changes in current cycle	107 (61%)
Municipal entities that have unapproved tariffs	48 (27%)
Municipal entities that have submitted completed 2001/2002 D-form information ***	122 (70%)
*** Please note that information submission and completeness figure pertains to the information required for tariff approval purposes, not for plant details, customer service, power quality, etc.	

From the foregoing analysis it can be seen that the number of licensees that is still applying non-approved tariffs is unacceptably high. The problem that the Regulator is facing in addressing this issue is twofold, namely the previously mentioned lack of punitive measures provided by legislation and the fact that with the advent of industry restructuring, tariff rationalisation and monitoring will be entering a new phase.

The lack and/or the quality of the of information is slowing down the tariff application process dramatically. Hence, why it is in the majority of times not

possible for the NER to process the applications in time.

Although not reflected in the above statistics, an underlying problem to tariff approval, especially if one wants to use rate of return regulation is the lack of proper ringfenced electricity departments/functions within municipalities. This problem will hopefully be reduced, if not totally eliminated, once the ringfencing exercise as is required in terms of the industry restructuring plan is completed.

What does the future hold from a regulatory perspective?

Although I can spend more of the available time discussing the problems being experienced by the Regulator, including issues, often interrelated, such as apparent lack of maintenance by some licensees of distribution assets, poor, or at best, only mediocre customer care, inadequate attention to reducing technical (and non-technical) losses, etc., I do not think that it will serve any purpose to continue with this theme here. It is time to look forward and not spend the time dwelling on the here and now. We have a good idea of what we need to look out for in the future, without having to fall in the trap of analysis paralysis. So, the industry restructuring and the proposed enabling EDI Restructuring Bill, in conjunction with the new ESI Regulatory Bill, is going to solve all the problems, right? No, wrong! The challenges to the Regulator, and to you the industry stakeholders, are not going to disappear. Some of the current problems and frustrations will most probably continue plaguing us for some time to come. In addition brand new, perhaps even more difficult to solve, problems will most likely rear their ugly heads. Will we be able to solve them? Yes, unequivocally, yes! Provided all of us work together to achieve it.

The first major uncertainty concerning the future dispensation that the Regulator, and the distribution industry, faces results from the current proposed EDI Restructuring Bill. This Bill, as you are all aware, deviates from the PricewaterhouseCoopers (PwC) Blueprint recommendation regarding the mandatory transferring of municipal electricity undertakings to the Regional Electricity Distributors (REDs). The Restructuring Bill is based on a voluntary transfer

system, which implies that REDs could possibly vary from just, on the one hand, Eskom's distribution function, presuming that it will be decreed that Eskom's distribution business will be transferred to the REDs, to REDs incorporating a mixture of Metro - and other municipal electricity distribution functions in various proportions. However, it is very likely that not all Metro's and municipalities will transfer their distribution assets to the REDs. This, you will realise, could vastly change the complexity of the Regulation of the industry. Currently the Regulator is, with the aid of consultants, working on the new regulatory framework, licence requirements, performance monitoring reporting - and industry information requirements as well as a tariff rationalisation approach and strategy based on the premise that all municipal electricity distribution businesses would be incorporated in the six REDs. All these aspects would need major rethinking if the model as proposed by the Restructuring Bill eventually becomes the definitive model.

To illustrate the added complexity, let us just look at two aspects, namely licensing and tariff rationalisation.

Although the licensing framework and requirements for the six distribution businesses has not yet been finalised, it had been foreseen that licenses would primarily be issued only to the six REDs, with perhaps a very small number of private distributors. Now, metros and municipalities that do not transfer their distribution businesses to the REDs would require to be separately licensed, possibly with similar, but not identical, licence conditions to those of the REDs. This will certainly increase the number of licences to be issued and the number of entities that would have to be monitored for compliance with the stipulated licence conditions. This aspect, together with the one mentioned in the next paragraph, would probably result in a larger workforce than originally foreseen by the Regulator under the proposed PwC model.

As it is, tariff rationalisation under the proposed PwC model is already fraught with problems in a multi-jurisdictional regulatory environment. This, however, becomes multi-fold more complex in the model prescribed by the ESI Regulatory Bill. In the PwC model, the Regulator together with the EDI Holdings Company and the industry at large have to finalise

how the very large number of existing tariffs are to be rationalised to a small number of “standard” tariffs. Although, as stated, the process has not yet been finalised, it would probably entail that not only the tariffs for the REDs would be approved by the Regulator but also the process or various tariff paths for the municipalities to ultimately conform to the approved “average” tariffs of the REDs. These paths would presumably have to be determined by the REDs so that over a pre-agreed period of time the tariffs charged within the different municipality conform to the average RED tariffs. These tariff paths and timeframes should ideally require approval by both the NER and the appropriate multi-jurisdictional municipal service districts or municipalities, the NER in its capacity as industry regulator and the latter entities in their capacity as service authorities. I believe that you will agree with me that this in itself will present a major challenge to managers and personnel of EDI Holdings, the REDs, the NER and municipalities. However, the ESI Regulatory Bill model now effectively imply that, over and above the involvement of the Regulator in the described process, it will also still have to possibly steer the tariffs, at this stage for an unknown number of metros and/or municipalities, as a separate exercise. Certainly not an easy task when one considers the extent of the number of tariffs currently in existence!

Please note that I have outlined the above mentioned complicating factors arising from the currently proposed EDI Restructuring Bill merely to illustrate the implications from a regulatory perspective and not to use this forum as an opportunity to debate the content of the proposed Bill. This is not the time nor the place to do so, many other forums and mechanisms exist to debate the contents of the Bill.

Aspects or issues that I do not have to time to spend sufficient time on during this presentation, but as mentioned earlier are extremely important include issues such as: poor, or at best, only mediocre customer care, inadequate attention to reducing technical (and non-technical) losses and what constitutes a “commercially” acceptable rate of return on distribution assets and the associated “effort” being spent by distribution personnel in providing a reliable and affordable electrical supply to customers? In addition to what degree is insufficient maintenance and refurbishment being

carried out on current distribution assets? If insufficient maintenance is being carried out, is this a consequence of low tariff levels or, perhaps, too high surplus margins? The debate on these, and other similar issues will have to continue in order to firm-up on the appropriate way forward for the Regulator.

Conclusion

Ladies and gentlemen. As I indicated at the start of this presentation, within the time available, it was only possible to briefly touch on problems currently being experienced by the Regulator and try and extrapolate some of these to the future. Perhaps I have not spent enough time on the way forward which, after all, is the title of this paper. But, I hope you will accept that I find it difficult to discuss a definitive way forward as there are still so many unresolved questions and issues. Suffice to say that with the appointment of the Board and Chief Executive Officer for EDI Holdings, a major step forward has been taken to start the very necessary electricity distribution reform process and the Regulator, and its personnel are keen, able and willing to rise to any challenges that may present themselves during the process. Provided we keep our lines of communications between ourselves open and remain prepared to listen and learn from each other, the electricity distribution industry will go from strength to strength for the benefit of all customers and stakeholders. I am sure that we will together find the appropriate level of regulation required, what represents the correct tariff levels to assure long term justifiable financial viability and what the ideal industry structure is. Please let us figuratively take hands and together build a electricity distribution industry that could serve as a model for the world, and in the process take the National Electricity Regulator one step closer to its vision of becoming a recognised world class regulator. Without your assistance, co-operation and support, this vision would remain a pipe dream, with very little chance of being realised.

Thank you very much.