

Keynote address by Mr Smunda Mokoena, chief executive officer (CEO) of the National Electricity regulator, delivered at the 59th AMEU Convention held in Polokwane on 26 September 2005

The Mayor of Polokwane, Councillor Thabo Makunyane

The President of AMEU, Mr Danie Potgieter

Dominee Frans Oosthuizen

Municipal Councillors

Municipal Managers

AMEU Members

Distinguished Guests

Members of the Media

Ladies and Gentlemen;

I am honoured and privileged today to give a key-note address to this important gathering marking the 59th Convention of the Association of Municipal Electricity Undertakings (AMEU) hosted by the Polokwane Municipality. The AMEU is a key stakeholder and NER ally in the electricity supply industry. From the regulatory perspective, we are encouraged by the fact that AMEU is a candid organisation that expresses its views openly and listens to the concerns of its members with microscopic eyes.

Ladies and gentlemen, this conference with an appropriate theme of "Solutions for Electrical Distribution Sustainability" takes place against the background of the restructuring of the distribution industry which has become a reality. During the President's State of the Nation address in February, the government made a commitment that the first RED must be established by July 2005. Indeed ladies and gentlemen the first RED was established in Cape Town in July 2005 and we are monitoring progress closely in fulfilling its mandate. This conference also takes place at a time when the National Electricity Regulator is celebrating a decade of effective and efficient electricity regulation.

During the past 10 years, the NER has made big strides in coming to grips with the challenge of a dynamic electricity industry. The highlights of achievements range from putting in place structures and systems that ensure sound corporate governance and capacity building, to the provision of current and user-friendly information, pricing systems, quality standards, publishing a National Integrated Resource Plan, developing a Rate of Return Methodology and Transmission Grid Code, as well as playing a leading role in the establishment of international, regional and national regulatory initiatives.

The NER also made a valuable contribution to the socio-economic development and prosperity of the people of South Africa, by regulating the electricity industry in accordance with government laws and policies, standards and international best practices in support of sustainable development. In addition the NER played a caretaker role for the disbursement of government funds for the national electrification program, until the Department of Minerals and Energy (DME) was in a position to take over its responsibilities.

I must commend the AMEU that during the ten years of our existence NER and AMEU have found or initiated solutions to very critical issues that face the electricity supply industry. The preparedness of the AMEU to nominate its members to NER working groups and the frank discussions to find solutions has moved the industry forward. We are preparing a book to reflect on the 10 years of regulation by the NER, in which the key milestones and the role played by stakeholders such as the AMEU will be recognised.

Masters of ceremony, this conference takes place during the time when the NER will cease to exist in March next year and its functions taken over by the National Energy Regulator (VERSA). The National Energy Regulator Act, Act No 40 of 2004 came into operation on 15 September 2005 and hence VERSA has been established as from that date. The Board of NER is scheduled to delist on 31 March 2005.

VERSA will regulate the piped-gas and petroleum pipelines industries, and will soon take over the regulation of the electricity industry in South Africa. VERSA will only begin regulating the electricity industry on 1 April 2006. The launch of VERSA is planned for November 2005.

With the establishment of VERSA the following changes must be noted:

- **The Regulator, VERSA, is an independent Regulator.** This means that decision making process of the Regulator may be challenged in court, but that it can no longer be taken on appeal to the Minister;
- **The way in which the Regulator must make its regulatory decisions** are prescribed to be: in the public interest; procedurally fair; and based on reasons facts and evidence that must be summarised and recorded.
- **Any decision of the energy regulator must be transparent.**

The practical implications will be increased consultation and longer time to reach regulatory decisions. However, there will now be three full-time members of the Regulator, in addition to the CEO, who may be delegated to sit as a subcommittee to conduct public hearings and to sit as a tribunal when hearing cases that may result in the imposing of fines.

The powers of the regulator to enforce compliance in the energy sector are greatly expanded because players such as the piped-gas business of SASOL and the petroleum pipeline business of PETR@NET, for instance, will now be regulated.

This rationalisation of the energy regulation in South Africa will benefit consumers of energy services in that the economies of scale will be realised resulting in reduced cost of regulation than it would have been otherwise. The cost allocation requirement of the VERSA Act and ring-fencing methodologies developed will ensure that each of the three regulated industries are not negatively affected.

Masters of ceremony, there are numerous challenges that the Regulator has to face during our ten years of existence. For the purpose of this paper, I will concentrate on the following challenges:

- Compliance monitoring;
- EDI restructuring;
- Electricity regulation Bill; and
- Maintenance and refurbishment backlog in the Municipal Electricity Distribution Infrastructure (MEDI)

Ladies and gentlemen, enforcement of compliance in the electricity industry has been a challenging area for the Regulator. There are many reasons for this including weak legislation, prioritisation of where to apply regulatory resources and the large number of licensees that needs attention. Key areas where municipal licensees struggle to comply are in providing the basic information that would be expected from a competent licensee and implementing approved electricity tariffs. Instead, some municipal licensees do not provide information at all and if they do, such information is of inferior quality and does not assist us to interpret it. Some municipal distributors also unilaterally implement illegal electricity tariffs.

The Regulator has initiated various initiatives to attempt to improve compliance.

- We are starting next month to roll out a new, improved, electronic licensee reporting system. Mr Caesar Vundule will be informing the meeting about this project.
- We have a programme of licensee audits that has started in 2003 and will be rolled out to all municipalities over the next five years. I will return to this aspect later.

The new VERSA legislation greatly improves the power of the Regulator to enforce compliance by licensees. This includes substantial fines that may be imposed by the Regulator sitting as a Tribunal.

In respect of distribution restructuring, **the NER strongly supports** government's stated policy of restructuring of the electricity distribution industry. This support has been demonstrated by our participation in the restructuring process and preparation of the NER to regulate the Regional Electricity Distributors (REDS). The objectives of the EDI restructuring as per the 1998 Energy White Paper are: to ensure electrification targets are met; to provide low-cost electricity; to facilitate better price equality; to improve the financial health of the industry; to improve quality of service and supply; to foster proper co-ordination of operations and investment capital; and to attract and retain competent employees.

The EDI restructuring Blueprint also provided for the specific needs of local government, in particular it was envisaged that a tax would apply to electricity supplied in their area of jurisdiction.

While we have made progress with electrification and with keeping electricity costs under control, there remain major concerns in the area of financial viability, service delivery and people development. We believe that the industry must be structured such that these aspects can be addressed by competent distribution entities which are properly regulated with the appropriate regulatory instruments to incentivise desirable behaviour.

The process of restructuring the distribution industry has taken much longer than anticipated and these delays have contributed to the unsatisfactory current state of the distribution industry. I trust that this will form part of your deliberations during this conference.

At this point it is appropriate for me to share with you our understanding as NER Cabinet's most recent decisions on EDI restructuring. Cabinet was briefed on a plan to accelerate the implementation of Regional Electricity Distributors (REDS), including the introduction of a Bill on Electricity Distribution Industry Restructuring. In this regard, it was agreed that six metro REDS plus a National RED needed to be investigated as soon as possible after the local government elections. Eskom would continue to play a critical role particularly in the National RED. The viability of this model is still to be tested and as a result, it is business as usual for us in so far as EDI Restructuring is concerned. I am sure **Ms Phindile Nzimande, CEO of EDI Holdings**, will brief you on these latest developments better than I can do.

From our point of view as well and irrespective of how the industry is to be structured or which entities are accountable for service delivery, the technical skills represented by the members of the AMEU will be required to deliver those services, which in my view are the most important skills for the industry.

Ladies and gentlemen, this conference also takes place at a time when Parliament is considering new legislation for the regulation of electricity industry in South Africa. We trust that the hopes and aspirations of the AMEU and its members will be fulfilled by these new pieces of legislation. The Electricity Regulation Bill has been published and will be presented to the Parliamentary Portfolio Committee on 14 October 2005 by the DME and public hearings will be held in November 2005. This piece of legislation has been under development over the past 10 years. Late additions to the Bill have resulted in a cloud hanging over the regulatory framework for the distribution industry.

It is government policy to regulate services that are not subject to competition. All participants in the business of providing electrical service to public customers are subject to economic regulation, because there is no competition in the South African Electricity Industry. All generators, transmitters and distributors of electricity are involved in regulated businesses. Therefore Eskom, the municipal generators and distributors, and licensed private suppliers (generators, transmitters and distributors) are regulated firms.

Existing legislation gives the NER powers to license the industry, to regulate electricity tariffs and prices, and to determine quality of supply and service standards. The new Bill seriously reduces the powers of the Regulator and takes regulation of electricity in South Africa back to before 1994 when the Electricity Control Board only had jurisdiction over electricity supply outside municipal areas of jurisdiction. The situation is in fact much worse since municipalities today have wall to wall areas of jurisdiction. It is pointless regulating Eskom effectively and then running the risk that 98% of electricity consumers do not benefit because the final supply to consumers are regulated ineffectively and operated inefficiently.

The Electricity Regulation Bill is a major deviation from the Electricity Act and it does not enable the intended restructuring of the electricity distribution industry. However, I am confident that the regulator, industry players and policy makers will find a way forward to an appropriate regulatory framework. The Regulator's position is clear in this regard.

Economic regulation of services requires information regarding efficient expenditure, service quality and the required revenues to deliver the services. The Regulator exercises its responsibility through the licensing of competent entities to deliver services. We believe that the role of the Regulator and the role of municipalities are not in conflict. Exercising executive authority over reticulation by municipalities complements the economic regulation of licensed electricity suppliers by the regulator.

In our view the Bill deviates from the intent of the Constitution and accepted government policy in that it gives a free interpretation of the constitutional rights of municipalities by equating the matter of 'electricity reticulation', which is an unregulated local government matter, with the supply of electricity, which is a regulated national matter. It also contains impractical compromises by negating years of investigative work and approved frameworks such as the EDI Restructuring Blueprint to the extent that it is unlikely that the intent of EDI restructuring will be achieved.

The implications of the Bill in its current form are far reaching:

- It effectively proposes to remove economic regulation from all low voltage customers in South Africa - i.e. the great majority: approximately ninety eight percent (98%) of electricity consumers in South Africa. The Bill accomplishes this in the following way: It defines electricity reticulation as the supply of electricity to domestic, commercial and light industrial customers in municipal areas; It then excludes municipal reticulation from the necessity of having a licence from the Regulator; It then states that municipalities must exercise their executive authority over reticulation by "setting and structuring tariffs" within their areas of jurisdiction. This includes not only areas currently supplied by municipalities - but also, in the future, areas currently supplied by Eskom or any other service provider within municipal boundaries.
- The regulator is then charged with monitoring and regulating the performance and compliance of municipalities to the requirements of the Act. However, the provisions whereby the regulator may do so are so complicated and elaborate that it will be unable to enforce compliance in any meaningful way. Monitoring municipal performance and setting national norms and standards is not economic regulation. Economic regulation requires a detailed understanding of the costs of each service provider and the careful setting of incentives to improve efficiencies. Policing of municipal activities by the Regulator is bound to be ineffective and could lead to wasteful deployment of resources. Simply put: "the proposed compliance procedures for municipal distributors are so cumbersome and over-elaborate that they are unworkable".
- There are major inconsistencies between the Bill and the recent legislation in the energy industry, namely the National Energy Regulator Act of 2004; the Petroleum Pipelines Act of 2003; and the Gas Act of 2001.

The Bill only makes sense if one believes government actually wants to disempower the Regulator and is not really committed to the establishment of the REDs. This is not the case. The National Energy Regulator Act of 2004, establishes the Regulator for the purpose of "the regulation of the electricity, piped gas and petroleum pipelines industries". Electricity is currently being supplied by certain municipalities and Eskom, hence the legislature could not have intended that the jurisdiction of the regulator should not extend to municipalities.

As NER, we will mobilise all available resources and means in opposition to the Electricity Regulation Bill in its current form and we will be approaching you as AMEU formally once we have detailed our submission to the Parliamentary Portfolio Committee on Minerals and Energy (PPC). We hope and trust that AMEU will join us in making strong submission to the PPC in favour of efficient and effective economic regulation of the electricity industry in South Africa. We must mobilise in opposition to the Bill in its current form as published 31 August 2005.

Masters of ceremony let me finally touch on the distribution maintenance backlog. The Minister in her Budget 'dote speech on the 15th May 2003 committed herself to ensuring that electricity distribution maintenance becomes a priority. The Minister emphasized the importance of maintenance and refurbishment of distribution networks in South Africa. The NER presented the summit with the findings of two surveys conducted for customers and licensees. The results detailed the facts and reasons for the lack of maintenance performed on electricity networks. Expectations were that critical areas would be addressed within 18 months. Unfortunately, I must admit that much of this was not achieved.

We have already undertaken a benchmark study to establish whether distribution costs are in line with international benchmarks to inform future prices. The industry, under the auspices of the Electricity Supplier Liason Committee has developed and approved a maintenance standard to give guidance to the maintenance process. That standard will be adopted as a license condition and compliance will have to be demonstrated for tariff review purposes. The Department of Minerals and Energy has made representations to Treasury for national government funding of the maintenance backlog with the support of the Departments of Public Enterprises and Provincial and Local Government.

The industry has to develop a standard giving guidance to performance management of distribution networks. It is imperative that industry establish an intensive skill development and training program for technical staff. Where skills are not available maintenance should be outsourced. Network planning must be intensified to cater for future demand and customer requirements.

The NEIL board has approved independent technical auditing of distribution infrastructure as part of enhancing its compliance monitoring function.

The AMEU regularly hosts this conference, which provides technical leaders of the industry with an opportunity to share learning experiences. I have had sight of the program for the next 3 days and have no doubt that the sessions will greatly enhance participants knowledge and help find solutions to common problems in the industry, and that will ultimately better prepare you to manage your functions more efficiently and effectively.

I would want to leave the meeting with the following challenges in your capable hands as the technical leadership of this industry:

- Development of the required skills to deliver the services expected by consumers;
- Identifying and addressing the maintenance and infrastructure backlog;
- Identifying and communicating the key risks facing the distribution industry as input to government policy formulation.
- As costs of electrification increase per household connection due to decrease in population density, that you will find technology solutions that will compensate for the increased costs.

Let us collectively move the electricity distribution industry to be comparable to the best in the world. We will have failed in our duty if electricity does not support, but constraints the economic and social objectives of government.

Before concluding, let me comment briefly on transformation. In perusing through your programme, I notice that you will also be receiving reports on or discussing the transformation of your organisation. If my reading is correct, I would like to encourage you to move in that direction and benefit from the experiences that we have had as a country and experiences of other organisations in South Africa that have gone through the same route . We are experiencing that by transforming from the National Electricity Regulator (NER) to the National Energy Regulator (VERSA). Good luck.

I would like to conclude by mentioning that this is the last time that the CEO of the NER will have the privilege of addressing this austere gathering. The NER bids you farewell as we move into an exciting area of energy regulation. The National Energy Regulator (VERSA) wishes the new leadership of AMEU well and looking forward to a warm relationship.

I want to thank the City of Polokwane for receiving us in the Capital City of Limpopo Province to further engage with you on a number of critical issues facing the electricity industry. The NER Board, and indeed VERSA, aims to use your City for a stakeholder meeting in the near future. These meetings have proved productive. It serves to inform stakeholders and to obtain information from stakeholders through direct contact.

I thank you for your attention.