

Electricity restructuring

Short-circuiting municipalities?

Important recent developments in the electricity distribution industry (EDI) could have a significant impact on municipalities. A recent court challenge raises the crucial issue of the right of municipalities to supply and distribute electricity.

The REDS plan

Discussions on restructuring the R25bn electricity distribution industry started as far back as the early 1990s. One reason for restructuring is that it could address problems of fragmentation, sustainability, efficiency and an apparent lack of cost effectiveness. It could also help establish tariffs that reflect costs and will make monitoring and regulating the service more effective.

The national Cabinet approved the restructuring process in 1999 and a blueprint for restructuring in 2001. The blueprint envisages the creation of six powerful and financially viable Regional Electricity Distributors (REDs) covering the entire country. They will be independent companies, created by merging Eskom's distribution business (Eskom is both a generator and distributor of electricity) with the electricity distribution businesses of 237 municipalities. The precise boundaries of each RED have not yet been finalised.

Implications for municipalities

Municipalities in each RED region will have to transfer their electricity distribution business and assets to that RED. They will then enter into a

key points

Plans for electricity redistribution mean municipalities will:

- have to transfer their electricity distribution business and assets to the Regional Electricity Distributor (RED) in their region.
- have to enter into a service delivery agreement with the RED to govern distribution of electricity in their municipal area.
- receive a 'municipal levy' to compensate for their loss of surplus from electricity distribution.

A legal challenge has been launched which argues that these plans are unconstitutional because they violate a municipality's right to supply and distribute electricity.

service delivery agreement with the RED to govern distribution of electricity in their municipal area. Each municipality will partly own their RED but the extent of their ownership will depend on the value of the assets that they transferred to it. The plan is to transfer municipal employees working in electricity distribution to the RED in their area. This will be the subject of continued talks with organised labour.

Many municipalities generate significant surpluses from electricity sales. These surpluses are often a large percentage of a municipality's income and the loss of that income would have a devastating effect on their financial viability. The

restructuring plan therefore guarantees the continued payment of surpluses to the municipalities by way of a 'municipal levy'. However, the exact details of how the levy will be imposed and what form it will take have not yet been finalised. Options include a direct levy by municipalities, a levy imposed by the RED itself on behalf of the municipality, or payment by some other means, such as shares, dividends or by contractual obligation.

A complicating factor is that there is also uncertainty on the precise total value of the surpluses generated by electricity sales. Estimates of the total annual value range from R2.4bn to R3.2bn. Agreement must also be reached on how the surplus is calculated, for example, is it merely a simple exercise of adding up the value of all surpluses or must hidden costs also be taken into account?

Another outstanding issue is the effect of EDI restructuring on local government finances generally. For example, electricity distribution services may have shared the use of various systems such as billing, records, information technology, fleet management etc. The effect of the loss of the electricity distribution function on the viability of these other systems needs to be assessed.

Where is the process now?

The holding company, EDI Holdings, has just been established and it will plan and manage the process of establishing the REDs. Government (through the Department of Minerals and Energy) wholly owns EDI Holdings with board representation for SALGA, Eskom and national government.

Key stakeholders, including SALGA and national government, have also recently signed a co-operative agreement paving the way for the restructuring process. The plan is to encourage individual municipalities to also sign this agreement. The agreement was drafted to ensure progress in the EDI restructuring in anticipation of any legislation. An electricity restructuring Bill is in the pipeline that will clearly define the rights and obligations of the various parties in the process.

The co-operative agreement requires municipalities to 'ring-fence' their electricity distribution businesses in preparation for transfer to the REDs. This means each municipality must create financially separate business units for their electricity distribution function.

However, the Municipal Systems Act raises a problem. Section 78 of the Act requires a municipality to go through an objective process of assessment before deciding what mechanism (business unit or otherwise) to use for a particular service (see *LGL Bulletin* 2001(4) pages 3–6). This means that if individual municipalities sign the co-operative agreement, they will effectively bypass the legislation. It has been suggested that section 78 of the Act should be amended to exempt municipalities insofar as electricity is concerned.

The timeline for restructuring envisages that municipalities will start the ring-fencing process from June 2002. It is expected that the establishment of the REDs will begin in October 2003 and end by October 2005. The REDS will then be monitored and evaluated until October 2007, after which EDI Holdings will be phased out.

The plan assumes municipalities can be compelled to transfer their electricity distribution business to a RED.

LEGAL ACTION

The entire plan appears to be based on the assumption that municipalities can ultimately be compelled to transfer their electricity distribution business to a RED. This raises questions about the actual extent of local government's autonomy and powers in electricity distribution. This issue is at the heart of a court case to be heard in November this year in the Pretoria High Court.

The City of Cape Town has instituted legal action against the National Electricity Regulator (NER), the Minister of Minerals and Energy (DME) and Eskom. Essentially it claims that it has the constitutional power to set its own electricity tariffs (without needing NER approval) and to supply and distribute electricity in its area without needing an NER-issued licence.

The City of Cape Town argues that its Schedule 4B function of electricity reticulation entitles it to make and carry out decisions about electricity

reticulation in its area and to exercise any power reasonably necessary for, or incidental to, the effective performance of its functions. This includes the right to set its own tariffs.

According to section 151 of the Constitution, national and provincial governments cannot impede or compromise a municipality in the exercise of its powers. In this respect, the City of Cape Town argues that the role of national government is restricted to support, strengthening and monitoring. It therefore argues that the NER has neither the right to licence the City, nor to determine its tariffs. Insofar as certain sections of the Electricity Act (41 of 1987) allow this, they are unconstitutional.

The NER, DME and Eskom dispute the City's interpretation of the meaning of 'reticulation' (discussed further below). Their main argument is that section 155(7) of the Constitution permits Parliament to regulate the exercise of a municipality's authority over Schedule 4B functions. Parliament therefore has the power to legislate in respect of electricity reticulation and the relevant sections of the Electricity Act are not unconstitutional.

One of the fundamental issues before the court is the meaning of 'electricity reticulation'. The Constitution gives local government the function of 'electricity and gas reticulation' (Schedule 4B). What does this mean?

The City of Cape Town argues that it means both the network and the supply and distribution of electricity through that network (i.e. both the 'wires' and the 'retail' business). NER, DME and Eskom argue that it means only the 'wires' and does not include the supply and distribution of electricity. They therefore argue that municipalities have no inherent power to supply and distribute electricity in their municipal areas.

The case will therefore clarify important issues about the extent of local government's powers in this field and the role and powers of the NER in relation to municipalities. The outcome of the case could also, indirectly, inform the nature of the relationship between municipalities and Eskom when it comes to Eskom distributing electricity in municipal areas.

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