MUNICIPAL TARIFF GUIDELINE, BENCHMARKS AND PROPOSED TIMELINES FOR MUNICIPAL TARIFF APPROVAL PROCESS FOR THE 2013/14 FINANCIAL YEAR

Consultation Paper

19 November 2012

Abbreviations and Acronyms

APP	Average Purchase Price
ASP	Average Selling Price
B	Bulk Purchase
BPI	Bulk Purchase Increase
C	Capital Charges
CCI	Capital Charges Increase
CPI	Consumer Price Index
D-forms	Distribution Forms
DSM	Demand Side Management
EPT	Electricity Pricing & Tariffs
ERA	Electricity Regulation Act
IBT	Inclining Block Tariff
IRM	Information Resource Management
kVA	Kilovolts-Amps
kWh	Kilowatt-hour
LF	Load Factor
MD	Maximum Demand
MFMA	Municipal Finance Management Act
MWh	Megawatt-hour
MYPD	Multi-Year Price Determination
NERSA	National Energy Regulator of South Africa
OC	Other Costs
OCI	Other Costs Increase
R	Repairs
RI	Repairs Increase
S	Salaries
SI	Salaries Increase
TOU	Time-of-Use
WACC	Weighted Average Cost of Capital

1. Executive Summary

The National Energy Regulator of South Africa (NERSA or 'the Energy Regulator') is the regulatory authority over the energy sector in South Africa and its mandate includes the regulation of the electricity supply industry. In terms of section 4(ii) of the Electricity Regulation Act, 2006 (Act No. 4 of 2006) ('the ERA'), the Energy Regulator must regulate electricity prices and tariffs.

The Energy Regulator approves an annual percentage guideline increase which is issued to municipalities prior to them preparing their tariff adjustment applications. This assists municipalities in preparing their budgets so that they can submit tariff applications to NERSA on time. This guideline does not preclude a distributor from the legal obligation to apply to the Energy Regulator for tariff increases before implementation. NERSA also reviews the tariff benchmarks and recommends new benchmarks to be used in the evaluation of the municipal tariff evaluations.

Comments on the consultation paper should be sent to: ***Ms Tabisa Nkopo at the National Energy Regulator of South Africa, Kulawula House, 526 Madiba Street (formerly Vermeulen Street), Arcadia, Pretoria. E-mail: municguideline@nersa.org.za.*** The deadline for the submission of comments is 10 December 2012.

After the consolidation of all the comments from stakeholders, NERSA will hold a public hearing in February 2013. NERSA wishes to state that the success of this process will depend on robust stakeholder participation.

2. Background

This consultation paper is limited only to price or tariff adjustments by municipal distributors and the municipal tariff application and approval processes. Eskom's prices are determined under a separate approach and methodology. The approach followed by NERSA allows licensees to submit their proposed price adjustments or tariff increases annually for approval by the Energy Regulator. This is done based on the percentage guideline increases issued by the Energy Regulator to all municipal distributors, based on the approved Eskom price. The submitted proposals are evaluated by staff and recommendations are made to the Energy Regulator for approval.

In determining the indicative guideline increase NERSA takes into consideration the approved Eskom bulk price of electricity to municipalities, and the increase on the municipalities' cost structures. It should be noted that due to the fact that the Energy Regulator will make a determination on the Eskom price increase in February 2013, NERSA has developed an indicative guideline based on various scenarios. The approved indicative guideline will in the interim assist municipalities in their budgetary processes.

2.1 Issues considered in the analysis of the municipal tariff review

The costs deemed not to be in the direct supply of electricity will be dealt with on a case-by-case basis from each municipality. These will be determined by comparing the municipalities' average cost to supply electricity with the average price charged by the municipalities. The difference will then be used to adjust the overall increase awarded to the municipality. In determining the average cost to supply the following factors, amongst others, will be taken into account:

1. bulk purchases;
2. bad debts;
3. reasonable energy losses;
4. salaries and wages; and
5. capital charges.

Furthermore, the municipalities' overall financial and technical performance will be reviewed prior to a final decision on the overall increase. Indicators to be considered in this regard mainly include:

1. percentage surplus;
2. percentage energy losses;
3. percentage power costs;
4. bad debt provision; and
5. average purchase price/average selling price ratio.

2.2 Submission of D-forms information

In order to ensure that a proper analysis is done and approval of tariff applications is achieved, NERSA requires correct and complete information by which the tariffs are to be determined. To this end, a need for consistent and high quality information has been identified. The required information for tariff analysis and approval includes both qualitative and quantitative data and must be in a form that is consistent with NERSA's objectives insofar as tariff principles are concerned and as stipulated in the ERA.

For municipal tariff applications to be properly analysed, NERSA depends entirely on the accurately completed information provided in the Distribution forms (D-forms). D-forms that are primarily used for tariff approval processes are D1 (Financial information), D2 (Market information) and D3 (Human Resources information). These forms contain information regarding the financial health and efficiency levels of the municipality, and also provide data regarding consumption and number of customers per tariff category, which will assist NERSA in its tariff analysis. The information also assists in determining the financial health of the municipality and in determining the revenues that the municipality collects from the various tariff categories (for example, the D-forms demonstrate the customer mix of the municipality and where the municipality collects the bulk of its revenue).

In the absence of the D-forms, or where inaccurate information is supplied, the analysis might not fully reflect the true financial or technical state of a licensee, who could be in a desperate financial situation that could otherwise have been minimised, had accurate information been provided.

Licensees are therefore urged to ensure that correct and accurate information is timeously submitted to NERSA. Access to the D-forms templates can be obtained through the NERSA website (www.nersa.org.za). It must be noted that the closing date for the submission of the D-forms was 30 October 2012, and that any municipal tariff application without the submission of appropriate D-forms information will not be considered.

Stakeholder Comment #1
Stakeholders are requested to comment on what measures NERSA should put in place in order to obtain quality data from municipalities that would assist NERSA with its tariff analysis?

3. Determination of the municipal tariff guideline

It should be noted that the indicative guideline that has been developed in this consultation paper is not the final approval of the Energy Regulator, since the determination on Eskom's MYPD3 application will be done on 28 February 2013. NERSA has developed the indicative guideline, based on various scenarios to assist municipalities with their budgetary process.

When developing the percentage guideline increase for 2013/14, the following issues were considered and some assumptions made.

The guideline for the 2013/14 financial year has been calculated after taking into consideration Eskom's MYPD3 application. In the MYPD 3 application Eskom has proposed a 16% average increase for the 2013/14 financial year. This increase amounts to 14.40%[1] for the municipalities. However, since this increase has not been approved as yet, NERSA has calculated municipal tariff guideline based on various scenarios as shown in Table 2 below.
The municipalities were divided into different consumption sizes based on their bulk purchases from Eskom. The determined different sizes are small, medium

[1] The 14.40% is indicated as the bulk purchase increase applicable to municipalities.

and large, respectively (0 – 50 MWh), (51 – 750 MWh) and (> 750MWh). This analysis was done in order to determine whether the weights of the cost drivers are still relevant for the development of the guideline for the 2013/14 financial year. The analysis done indicated that the weights of the cost drivers can still be utilised, in determining the weighting of the electricity supply costs for the 2013/14 financial year.

Table 1: Municipal cost structures

% Purchases	70
% Salaries and Wages	10
% Repairs	6
% Capital charges	4
% Other costs	10

The following assumptions on cost increases were made:-

- bulk purchases will increase by a range of between (5.3% to 14.40%)[2] in line with Eskom's increase to municipalities;
- Consumer Price Index (CPI) – 5.3%[3];
- salary increases – CPI plus 1.25%[4] ;and
- repairs and maintenance, capital charges and other costs will increase by CPI.

The proposed Eskom price increase for Municipalities:

Municipal distributors purchase their energy requirements from Eskom, who generates 96% of the energy that is consumed in the country. It is therefore necessary that when considering the level at which municipalities will increase their tariffs, the Eskom price increase be taken into consideration.

The analysis of other municipal costs besides purchase costs:

While purchase costs make up the bulk of municipal costs (an average of 70% based on the sample used in the analysis) municipalities are also subjected to other costs like operating and maintenance costs. Increases in these costs have a bearing on the municipalities' ability to distribute electricity.

2 The range for the bulk purchase increase is based on the various scenarios that NERSA is assuming.

3 As indicated in the Medium Term Budget Policy Statement 2012(MTBPS)

4 As indicated in Circular No. 6/2012: Salary and Wage Collective Agreement

The formula for calculating the guideline

MG = (B x BPI) +(S x SI)+(R x RI)+(C x CCI)+(OC x OCI)

Where:-

- MG = % Municipal Guideline Increase
- B = Bulk purchases as percentage of total cost
- BPI =% Bulk purchase increase
- S = Salaries as percentage of total costs
- SI = % Salaries increase
- R = Repairs as percentage of total costs
- RI = % Repairs increase
- C = Capital charges as percentage of total cost
- CCI = % Capital charges increase
- OC = Other costs as percentage of total cost
- OCI= % Other costs increase

Table 2: Calculation of the guideline for the 2013/14 financial year based on various scenarios

		SCENARIO 1: (5.3% increase)		SCENARIO 2: (10.0% increase)		SCENARIO 3: (14.40% increase)	
COST LINE ITEM	REVISED MUNIC % OF TOTAL COST	EXPECTED INCREASE %	WEIGHTED AVERAGE EXPECTED INCREASE	EXPECTED INCREASE %	WEIGHTED AVERAGE EXPECTED INCREASE	EXPECTED INCREASE %	WEIGHTED AVERAGE EXPECTED INCREASE
Purchases	70%	**5.30%**	3.71%	**10.0%**	7.00%	**14.40%**	10.08%
Salaries and wages	10%	6.55%	0.66%	6.55%	0.66%	6.55%	0.66%
Maintenance/Refurbishment/recapitalisation	6%	5.30%	0.32%	5.30%	0.32%	5.30%	0.32%
Capital charges in total	4%	5.30%	0.21%	5.30%	0.21%	5.30%	0.21%
Other charges	10%	5.30%	0.53%	5.30%	0.53%	5.30%	0.53%
% increase			**5.43%**		**8.72%**		**11.80%**

3.1 Municipalities applying for an increase that is above the guideline will have to justify their increases to the Energy Regulator and the decision will be based on the following requirements:

1. a full analysis of additional funds requested needs to be presented to NERSA as part of the motivation for the above-guideline increase (the municipality must give a detailed revenue analysis where it indicates the revenue when using the approved guideline percentage increase and add the revenue and list of items, i.e. repairs and maintenance, where the extra funds will be allocated);
2. the approved funds must be ring-fenced to ensure that it is strictly utilised for the identified projects;
3. municipalities must report to NERSA on a six-monthly basis on how the additional funds are utilised; and
4. funds not utilised for the purpose for which they were approved will be clawed back in the following financial year.

Stakeholder Comment # 2

Stakeholders are invited to comment on whether municipalities should be granted an increase that is above the guideline, if not, to propose possible alternatives for municipalities to collect their required revenues.

4. Municipal Electricity Tariff Benchmarks

The existing benchmarks are based on five assumed tariff/customer categories and average consumption levels for these categories. It should be noted that these are average consumption levels and that there may also be other tariff classes at various municipalities which will cater for other customer classes or consumption levels that are very different from the ones that are assumed. Where such different circumstances exist, the applications will be treated on a case-by-case basis.

Municipalities applying for tariffs that are outside the approved benchmarks must justify such increases and the following information must be submitted:

1. the total number of customers per tariff category – municipalities that do not have an appropriate customer base must submit the full detail of its customer profile, as well as the associated revenues;
2. expected revenues per tariff category;
3. the forecasted total sales;
4. the average maximum demand per tariff (where applicable);
5. the average load factor (where applicable); and

6. the load profile in percentages (both summer and winter, where applicable).

4.1 The municipal customer categories

In developing the benchmarks, NERSA has been assuming the following customer classes:

- Domestic Tariffs
  - Block 1 (1 – 50 kWh);
  - Block 2 (51 – 350kWh);
  - Block 3 (351 – 600kWh); and
  - Block 4 (> 600kWh).
- Commercial (small business) single phase tariff – An average consumption level of 2000kWh per month.
- Commercial Prepaid – An average consumption level of 2000kWh per month.
- Industrial/Large user tariff – A 30.00% load factor (LF) and a maximum demand (MD) of 200kVA, which would give an average consumption level of 43 800kWh.
- Industrial Time-of-Use (TOU) – A 30.00% LF and an MD of 200kVA, which would give an average consumption level of 43 800kWh. The customer profile (i.e. peak, standard, off – peak).

4.2 The NERSA review processes

Due to some concerns that have stemmed from the industry, NERSA has embarked on rigorous processes in order to address the concerns of the stakeholders. As a result of these concerns NERSA is reviewing the current municipal tariff benchmarks.

1. NERSA is currently in the process of reviewing municipal tariffs, both within each municipality and across all municipalities. The decision of the Energy Regulator in reviewing such tariffs will have to be incorporated when developing the benchmarks as this will have an impact on the approved tariff structures.

2. The Energy Regulator is expected to make a decision on the review of the Inclining Block Tariffs (IBTs) in December 2012. This will assist in determining appropriate tariff structures that will suit municipalities' specific circumstances.

3. NERSA has received a large volume of complaints on the unit costs of the demand that municipalities charge. These complaints indicate the excessive kVA variations between municipalities and Eskom.

   3.1 The cost of sevice (COS) study would be a key resource for an appropriate rate design for municipalities. It is for this reason that municipalities are encouraged to undertake COS studies. In the absence of such studies NERSA will benchmark their tariffs with the Eskom tariffs.

   3.2 The municipalities with high demand charges and low energy charges are encouraged to restructure their tariffs by shifting a portion of the demand cost recovery from the demand charge to the energy charge.

   3.3 The Eskom review tariff analysis based on the MYPD 3 application is also under way, and the decision on the approved structural tariffs will be in February 2013. This will also have an impact on the tariff structural changes of the municipalities.

   3.4 Municipalities must also consider the load factors of their customers when determining the kVA charge and give options to customers with a high or low load factor.

Stakeholder Comment # 3

Stakeholders are requested to comment on the NERSA processes that are underway.

Stakeholder Comment # 4

Stakeholders are invited to comment on the phasing in of the alignment of the municipal demand and energy charges to those of Eskom.

5. Financial Benchmarks

Table 3: Financial benchmarks

	Current Average Benchmarks	Revised Average Benchmarks	Financial Benchmarks (Tolerable Range)
Percentage Power cost	70%	70%	58% - 78%
Percentage Surplus	15%	15%	10% - 20%
System losses	10%	10%	5% - 12%
Average Purchase Price/ Average Sales Price ratio	1: 2.1	1: 1.64	

NERSA is in the process of gradually reducing the average purchase price and average sales prices ratio. As the high price variations between the municipal and Eskom tariffs have become noticeable. In revising the Average Purchase Price /Average Selling Price (APP/ ASP) ratio a sample of 115 municipalities was used to determine an average APP/ ASP ratio. The information from the 2010/11 distribution forms was used to determine this average.

Stakeholder Comment # 5

Stakeholders are invited to comment on whether the financial analysis is appropriate for determining the efficiency of the municipality.

6. Timelines for municipal tariff approval process and guideline determination

Municipalities are bound by among other legislations, the Municipal Finance Management Act (MFMA) and Municipal Systems Act. According to the MFMA budgetary process, National Treasury issues a budget circular annually to all municipalities by the end of November.Ideally, this circular should take into account NERSA's approved guideline increase; however this will not be possible in the current cycle due to the guideline determination being dependent on the approval of the MYPD3, which will only occur on 28 February 2013.

NERSA will provide National Treasury with the indicative guideline which municipalities can use to base their draft budgets on. It is anticipated that municipalities will compile and submit draft tariff applications for NERSA's consideration from January 2013. NERSA will then determine and approve the final municipal tariff guideline on 28 February 2013[5]. The approved guideline will be communicated to municipalities who will then adjust their budgets accordingly.
Section 43 of the MFMA (Act No. 56 of 2003) states that:

[5] Tentative date – (NERSA 2013 shedule of meetings not yet approved)

(1) If a national or provincial organ of state in terms of a power contained in any national or provincial legislation determines the upper limits of a municipal tax or tariff, such determination takes effect for municipalities on a date specified in the determination.

(2) Unless the Minister on good grounds approves otherwise, the date specified in a determination referred to in subsection (1) may-

a) If the determination was promulgated on or before 15 March in a year, not be a date before 1 July in that year; or

b) If the determination was promulgated after the 15 March in a year, not be a date before 1 July in the next year.

Based on the delay in the determination of the municipal guideline and on the above-mentioned MFMA constraint, NERSA has requested an extension of the timelines for the finalisation of the municipal electricity tariff determination from the Minister of Finance.

The table below shows the timelines and processes leading to the approval of municipal electricity tariffs.

Table 4: Timelines and processes leading to the approval of municipal electricity tariffs

ACTIVITY/TASK		**DATE**
NERSA/ MUNICIPAL PROCESS	**NATIONAL TREASURY/MFMA BUDGETARY PROCESS**	
Due date for municipalities to submit their D-forms for the next tariff applications process		30 Oct 12
Modelling of municipal tariff guideline & benchmarks		Oct – Nov 12
Publishing of the consultation paper on NERSA website		16 Nov 12
	National Treasury issues a budget circular to all municipalities	End Nov 12
Public Hearing for the municipal guideline increase and benchmarks		05 Feb 2012
NERSA's decision of the municipal guideline increase and benchmarks		28 Feb 13
Communicate guideline increase to municipalities		01 Mar 13
	Mayor tables municipal and entity budgets and budget related policies (Draft) for consultation processes	Mar 13
Municipalities compiles and		Jan - May 13

submit tariffs application for consideration by NERSA		
	• Public submissions on draft budget • Council hearings to consider submissions • Mayor resubmit amended budget for council approval and adoption	Apr- May 13
NERSA's consideration and approval of tariff applications and communication of NERSA's decision to municipalities		Feb - End May
	Finalised budget is tabled in Council again	01 June 13
Implementation of approved budget including NERSA-approved tariffs		01 Jul 13

<u>Stakeholder Comment # 6</u>

Stakeholders are invited to comment on the appropriateness of the municipal tariff approval process and timelines with regard to the MFMA prescribed budgetary process.

<u>End</u>