

RED1 Licence Application

NATIONAL ENERGY REGULATOR OF SOUTH AFRICA

In the matter regarding an

APPLICATION FOR AN AMENDMENT TO ELECTRICITY DISTRIBUTION LICENCE HELD BY RED ONE (PTY) LTD

by
REGIONAL ELECTRICITY DISTRIBUTOR ONE (PTY) LTD.

in the area of
CAPE TOWN

1. Decision of the Energy Regulator

After considering the facts and evidence that were presented to the Licensing Subcommittee of the Energy Regulator in a public hearing on the 7 December 2006, including the documents that were submitted prior to that hearing, the Energy Regulator decided the following:

the application for an extension of the RED1 licence **NER/D/R/RED 1** is declined;

to facilitate the legal distribution of electricity in Cape Town, the electricity distribution and supply licence **NER/D/CAPETOWN**, that had been transferred to RED1, must be amended or varied at Clause 3: Term of Licence to read 1 January 2007 until 31 June 2007.

2. The application

The licence to distribute and supply electricity issued to Regional Electricity Distributor One (Pty) Ltd. **NER/D/R/RED 1** required that "its validity shall be reviewed by the 31 December 2006." (Para 3.1).

In its letter dated 23 October 2006 Regional Electricity Distributor One (Pty) Ltd. effectively applied for the term of its licence to be extended from December 2006 to July 2008 on the grounds that certain of the licence conditions were not yet fulfilled and in the circumstances could not be

fulfilled by the required December 2006 deadline. In a subsequent letter dated 26 October 2006, RED 1 requested that the period be changed to an indefinite period given the Cabinet decision of 25 October 2006.

The Energy Regulator published notices of its scheduled public hearing on this matter in national newspapers on 29 November 2006 and 3 December 2006 and invited the public to submit written views as well as to present facts and evidence at the public hearing. A number of interested and affected parties accepted this offer.

In its letter dated 4 December 2006 the City of Cape Town requests NERSA to transfer back to the City, the electricity supply and distribution licence previously transferred to RED1, with effect from January 2007.

3. The applicant

RED1 applied for the extension of the licence NER1/D/R/NER1 for a period of 18 months which was later changed by the applicant to an indefinite period.

The City of Cape Town also applied for the transfer of the abovementioned licence back to the City.

4. The objectors and other intervening parties

The City of Cape Town submitted letters of objection to the extension of the RED1 licence.

5. The public hearing

A public hearing on the application under consideration was convened by the Licensing Sub-Committee of the Energy Regulator on 7th December 2006.

This public hearing was duly advertised.

The following were represented and gave oral evidence and/or written submissions -

Regional Electricity Distributor One (RED 1)
EDI Holdings (EDIH)
Eskom Holdings
City of Cape Town
NERSA Secretariat

The following were invited and confirmed their attendance but did not give evidence:

Department of Minerals and Energy;
Department of Public Enterprise.

6. Applicable Law

The legal mandate for the Energy Regulator to award licences is derived from the National Energy Regulator Act, 2006 (Act No 40 of 2004) and the Electricity Regulation Act, 2006 (Act No. 4 of 2006) .

7. Basis of the decision by the Energy Regulator.

The RED1 licence, NER/D/R/RED 1 was issued subject to the following conditions being met by the dates specified:

- (i) The 'Operating and Transitional Plan for Transfer Agreement' (OTPTA) between City of Cape Town and RED1 being approved by the NER.
- (ii) All electricity customers, assets and staff belonging to the City of Cape Town be transferred to RED1 by December 2006.
- (iii) All non contestable electricity customers, assets and staff belonging to the Eskom distribution business in the RED1 end-state-area be transferred to RED1 by December 2006.
- (iv) All electricity customers, assets and staff belonging to the majority of the remaining municipalities in the RED1 end-state-area to be transferred to RED1 or SDA's concluded with RED1 by December 2006.
- (v) The phasing in of contestability and wholesale purchasing only be considered once Eskom distribution is incorporated into the RED.

The OTPTA between the City of Cape Town and RED1 was signed on the 28 June 2005 and approved by the NER.

The City of Cape Town, Eskom and RED1 testified that conditions (ii), (iii), (iv) and (v) of the RED1 Licence (NER1/D/R/RED 1) were not met and will not be met by the dates specified.

The main reason provided by RED1 for not meeting the above-mentioned conditions is the absence of enabling legislation such as the absence of the national asset transfer framework and the Electricity Distribution Industry Restructuring (EDIR) legislation.

RED1 and EDIH hope that the national asset transfer framework and EDIR legislation will be finalised by June 2007.

There was no indication given by the respective parties as to when the abovementioned legislation will be in place and NERSA is unaware of a due date for such legislation. The Department of Minerals and Energy and the Department of Public Enterprise did not present their views at the hearing.

Based on the due process that is followed in promulgating legislation, it is the considered view of the Energy Regulator that, the EDIR legislation and a national asset transfer framework are not likely to be ready and be operational by June 2007.

Eskom and EDIH support the extension of the RED1 licence for a 6 month period because they claim it will maintain the impetus of restructuring the electricity distribution industry as well as ensure that the parties involved continue to negotiate with each other regarding the restructuring processes.

Eskom, EDIH and RED1 argue that the extension of the licence will ensure that the gains made by the establishment of RED1 are not lost.

The City of Cape Town indicated categorically that it will not renew the SDA, OTPTA and any other related agreements. The basis for their stance was the Cabinet decision of the 25 October 2006 which amended the original conditions of the agreement which were that the RED would be a municipal entity. The press release issued regarding the Cabinet decision of 25 October 2006 states that it would be a public entity and not a municipal entity.

The City of Cape Town indicated that their intention is to take over the activities that were transferred to RED1 when the licence expires or terminates on 31 December 2006, as provided for in section 81(2)(e) of the Municipal Systems Act, 2000, (Act No. 32 of 2000).

The City of Cape Town further alleged that as the legal position stands now in South Africa, electricity reticulation¹ in the City of Cape Town is the constitutional right of the City of Cape Town and referred to section 156(1)(a) of the Constitution of the Republic of South Africa Act, 1996, (Act No 108 of 1996). There is no legal basis to compel the City of Cape Town to enter or renew any agreements with RED1. In fact, since RED1 is 100% owned by the City of Cape Town, it was within

¹ We note that during the public hearing the City of Cape Town did use the term “distribution” on occasion and that in part B of Schedule 4 to the Constitution of the Republic of South Africa the term electricity “reticulation” is used.

their prerogative to consider liquidating RED1 should there be any attempt to force the City of Cape Town into a compromise solution.

The City of Cape Town reported that they had resolved to suspend all actions pertaining to RED1 until there is certainty around the restructuring of the electricity distribution industry.

The City of Cape Town also made it clear that if the Energy Regulator extended the RED1 licence, they would not renew the Service Delivery Agreement (SDA) with RED1 and effectively this would make RED1 a licensed entity without any capacity to distribute electricity. RED1 can be made dormant and kept for future use.

Further, the SDA between the City of Cape Town and RED1 provides that any renewal of the agreement shall be by consensus between the parties.

In view of the above, the Energy Regulator believes the following:

NERSA has no legal basis to compel the City of Cape Town to renew its agreements with RED1.

Without the SDA and other necessary agreements RED1 cannot fulfil the requirements that the licence will place on them.

The progression of the EDIR is not dependent on the extension of the RED1 licence and will happen when the enabling legislation is promulgated.

The non-renewal of the SDA by the City of Cape Town implies that the enabling condition for issuing the licence to RED1 is no longer satisfied.

Taking into consideration the efforts and momentum that have been contributed through the existence of RED 1, Government's stated policy as announced by the President in the State of the Nation Address of 2004 and also not wanting such momentum to be lost, the Energy Regulator considered anticipating the requirements of the pending legislation and evaluated the option of issuing separate licences to Eskom, RED1 and the City of Cape Town to facilitate the continuation of the restructuring momentum as required by Eskom, RED1 and EDIH.

After extensive deliberations, including the discussions around the path the national government has embarked on in the restructuring of the

electricity distribution industry, the Energy Regulator was of the view that the priority was for the Energy Regulator to be seen to be predictable and to promote order in the manner that it regulates. The Energy Regulator needs to establish and ensure order and predictability in the Electricity Supply Industry.

In this regard, the manner in which the Energy Regulator will oversee the restructuring process should be governed by the abovementioned principles. Therefore, the restructuring process is and will be driven by the relevant legislation which is currently under development.

In the absence of such legislation the actions of the Energy Regulator must be premised on and driven by existing and relevant legislation as well as by the objects of the Acts governing the Energy Regulator.

It is the considered view of the Energy Regulator that RED1 cannot be reasonably expected to fulfil its licence conditions and therefore the matter of security of supply and delivery of electricity to consumers needs to be addressed.

The Energy Regulator is required by Section 4(a)(i)(aa) and (cc) of the Electricity Regulation Act, 2006 (Act No. 4 of 2006) to consider applications for licences. The City of Cape Town also applied (letters dated 11 November 2006 and 4 December 2006) for the licence to distribute and supply electricity in the areas where the SDA was applicable.

The Eskom distribution licences and other distribution licences expire on 30 June 2007.

The abovementioned licences were issued under the Electricity Act, 1987 (Act No. 41 of 1987) and these need to be aligned with the subsequently promulgated requirements of the Electricity Regulation Act, 2006 (Act No 4 of 2006), such as Section 8 (1). The existing licenses licence the entities *“to distribute and supply electricity”* whilst the new licences under the Electricity Regulation Act, 2006 (Act No. 2 of 2006), need to make reference to *“operating the distribution facility and trading or involved in trading”*.

It is anticipated that the Electricity Regulation Act, 2006 (Act No. 4 of 2006) Regulations will be gazetted by June 2007. The Energy Regulator has embarked on a consultation process with the licensees on the formulation of Rules, as required by the Electricity Regulation Act, No 4, 2006, section 47(1). The consultation process and formulation of the rules is planned to be completed before 30 June 2007. The Energy Regulator will prescribe new licence procedures thereafter, as

contemplated in Section 11(1)(a) of the Electricity Regulation Act, 2006 (Act No 4 of 2006).

The Energy Regulator intends to issue new licences in accordance with the Electricity Regulation Act, 2006 (Act No. 4 of 2006) to the distributors from 1 July 2007.

C. Matjila (Chairperson)

Date