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Report

Cities' Powers to Regulate Electricity Generation and Reticulation in relation to SSEG

20 November 2018

C40 CITIES
CLIMATE LEADERSHIP GROUP

SEA SUSTAINABLE ENERGY AFRICA

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NERSA	National Energy Regulator of South Africa
PV	Photo-voltaic
SA	South Africa
SSEG	Small-scale embedded generation

1 Objective of this note

The C40 South African New Buildings Programmes is exploring ways to promote a zero-carbon building scenario in the country. The focus of this programme has turned to the promotion of small-scale embedded generation (SSEG) of electricity, i.e. the generation of electricity on site by households and firms primarily through the use of rooftop solar PV .

This note identifies the legal issues related to the promotion of SSEG, explores the legal uncertainties that need to be clarified in this work and suggests a set of way forward and actions necessary to achieve the legal certainty needed to roll out SSEG at scale in South African municipalities. This roll out would require regulation, i.e. it cannot be a free-for-all, and the questions to be asked include: what are the appropriate standards to be prescribed for SSEG; and, which sphere of government may exercise regulatory power in relation to SSEG?

2 The Constitutional framework for electricity services

The Constitutional framework for electricity is premised on two separate functions: the *generation* of electricity and the *reticulation* of electricity. Each of these functions is treated differently under the Constitution:

- The generation of electricity is a residual national competence, which means that national government has the power to make law that regulates electricity generation and it can use that power to determine who may generate electricity (and who may not), and how it is generated.
- Electricity reticulation (or distribution) is however a municipal function in terms of Schedule 4, Part B of the Constitution, and particular rules apply to that category of municipal function.

Where a function falls in Schedule 4, Part B – as electricity reticulation does – national (and provincial) government enjoy concurrent powers to regulate the manner in which reticulation is carried out by a municipality. Such regulation however must be in the form of norms and guidelines, it cannot be so prescriptive as to hinder a municipality in the implementation of its competence to regulate reticulation, it has to leave a municipality with the decision-making space to ensure that its interests and those of its citizens are adequately addressed in the day to day regulation of the reticulation system.

As with any other Schedule 4, Part B function, national (and provincial) government are obliged to support and monitor the efforts of municipalities to exercise their powers. The current manner in which the national government regulates municipal generation and trading of electricity is via NERSA, in terms of the Electricity Regulation Act, 4 of 2006 (see next section). The reticulation of electricity is also governed by that Act.

It is important to remember that although both generation and reticulation are governed by the same piece of legislation, distinct rules apply to the regulation of each function in terms of the Constitution. In relation to both functions the Minister holds important powers to issue regulations and Schedules to the Act. In relation to reticulation municipalities also hold law-making powers, in terms of their ability to make by-laws governing matters falling under Schedule 4, Part B of the Constitution.

Regardless of how electricity is generated, whether by a municipality, ESKOM or a private enterprise and whether from renewable or non-renewable sources, the power to regulate the amount of electricity generated and the price at which it is sold to consumers (or resellers) is NERSA.

3 The Electricity Regulation Act

The Electricity Regulation Act, Act 4 of 2006 (as amended in 2007, the 'ERA') establishes the legal framework for the delivery of electricity services. The ERA:

> '…provides a broad framework for the regulation of a municipality's reticulation competence, and leaves much of the detail to be filled in by regulations issued by the Minister for energy and the National Electricity Regulator of South Africa (NERSA).'[1]

In relation to **generation** the Act is specific:

- Section 7 the Act confirms that any generation (or trading) of electricity has to be **licenced** by NERSA and any person (or municipality) can apply to be licenced. Any licencing decision by NERSA has to be rationally connected to the mandate of NERSA as set out in the law, i.e. licencing decisions cannot be made arbitrarily. This is especially the case in relation to an application by a municipality for a licence as municipal generation of electricity is a constitutional power, albeit one subject to regulation by NERSA[2].
- Schedule 2 to the Act lists the types of generation that do **not** need to be licenced (which include a generation plant for 'own use' and non-commercial 'non-grid connected supply'), i.e. to which section 7 does not apply. See Figure 1 below for Eskom's illustration of the current scheme prescribed by Schedule 2.
- Section 9 provides for the **registration** (which is different to, and less onerous than, licencing in terms of section 7) of activities 'relating to trading or the generation … of electricity', and these activities can be prescribed by the Minister.

[1] Steytler and De Visser (2018) *Local Government Law of South Africa*.
[2] Steytler and De Visser (2018) raise an important argument, at section 6.3.3 of Chapter 17 of *Local Government Law of South Africa*. There they point out that NERSA's role in licencing municipalities to generate electricity may well be unconstitutional. They argue that a municipality is constitutionally empowered to reticulate electricity. In fact, following the Constitutional Court's decision in the case of *Joseph v City of Johannesburg*, 2010 (3) BCLR 212 (CC), a municipality is obliged to provide electricity as an essential basic service. Steytler and De Visser contend that in this scenario it is not proper for NERSA to decide whether or not a municipality may reticulate electricity, although the Minister may determine norms and standards with which it must comply when it does so.

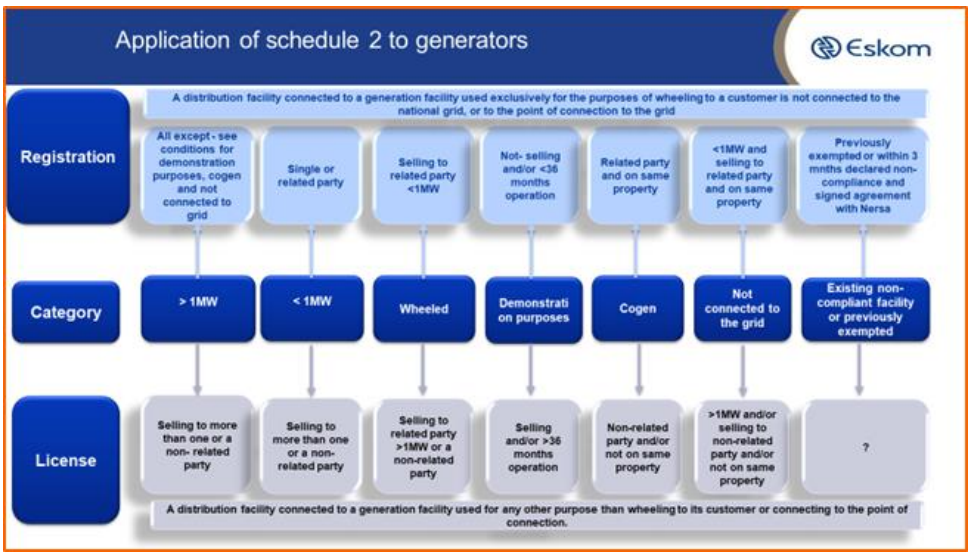

Figure 1: Eskom diagram illustrating Schedule 2, ERA

Simply put, in relation to SSEG, the Act requires licencing of any generation that is not for own-use, i.e. where there is any sale of electricity generated privately to the municipality. Where a household or firm generates electricity for itself and consumes that electricity itself there is no need for licensing (or registration). As soon as there is a transaction that entails the delivery of the electricity to another user or the municipality, a licence is needed.

In order to make this legal framework more conducive to SSEG, and to align with the practices being considered in a number of Cities, the Minister of Energy issued in June 2018 a draft Licencing Exemption and Registration Notice[3]. If this notice is enacted as it stands it will introduce far-reaching changes to the legal landscape. In summary the 2018 notice proposes the following, to be achieved by a **new Schedule 2** to the Act):

1. **Exemption from licencing of the following activities (although all of them must be registered)**
    - Generation where the installed capacity is less than 1 MW, where it is connected to the national grid and supplies electricity to a single customer with no wheeling, provided that the generator or the single customer has either a 'user of system agreement' or obtained approval from the body that holds the relevant distribution licence (in cities this will mainly be a municipality).
    - Generation where the installed capacity is less than 1 MW, where it is connected to the national grid and supplies electricity to a single customer with wheeling, provided that the generator or the single customer has a 'user of system agreement' with the body that holds the relevant distribution licence (in cities this will mainly be a municipality, although see footnote 2 for discussion on whether or not the principle of licencing a municipality to distribute electricity is constitutionally defensible).

[3] Government Gazette 41685, no. 563, 8 June 2018.

- Generation where the installed capacity is less than 1 MW, where it is not connected to the national grid and supplies electricity only to the owner of the facility, for consumption by a relative of the owner or consumption on the same property.
- Generation for demonstration purposes of electricity that is not sold, and is only active for a period of three years or less.
- Generation that is a 'co product, by-product, waste product or residual product' of an 'underlying industrial process', where the electricity generated is only used by the owner of the industrial facility in which the process takes place, or where it is for a relative of the owner, or is to be consumed on the same property.
- Reselling of electricity by a person who has purchased electricity from a licenced distributor of electricity, where the reseller is charging a tariff that is the same as or less than what the licenced distributor would have charged to the same customer(s) and/or where the licenced distributor is connected to the same bulk point as the one that would otherwise have served the customer(s). In this case the reseller has to conclude a service delivery agreement, in terms of the Municipal Systems Act, which must also be approved by NERSA, in detail[4].

2. **<u>Exemption</u> from the requirements both to licence and/or register an activity:**
   - Where the generation is purely and only for back up purposes, in anticipation of an electricity supply disruption, in which case it can only be active for the duration of the disruption.
   - Where the generation is a continuation of an 'existing generation facility' that immediately before the new rules come into effect was exempt from licencing, so where the generation plant is and was for 'own use' and non-commercial 'non-grid connected supply'.
   - Where the generation is a continuation of an 'existing generation facility' but where it is non-compliant with the new requirements and declares non-compliance as well as agreeing to comply with timeframes specified by NERSA.
   - Where the generation is registered (i.e. not licenced) and is solely for the purposes of wheeling that electricity either to a customer or a point of connection, both through the national grid.

[4] Note that the provisions of the draft notice relating to reselling are somewhat vague. Presumably they will be firmed up in the final version of the regulations. In any event, reselling is only possible in the case of a **licenced** distributor, not a **registered** one.

4 Areas for clarification

The first and most obvious concern is that it is not known whether the Department of Energy will enact the new Schedule 2 as set out in the Gazette or whether the comments received (the closing date was in early July 2018) will cause the Department to deviate from the proposed approach.

The provisions of the draft Schedule 2, Gazetted on 8 June 2018, are vague and unclear in relation to reselling and this will need to be clarified.

The provisions of the draft Schedule 2 are also vague and unclear in relation to wheeling and this will need to be clarified. This is an area in which there is likely to be growing interest from the private sector and there is a concern that the combination of legal uncertainty with distributor systems that are not able to accurately charge for the service of grid access for wheeling will stunt progress.

The proposed new approach to licencing and registration in the June Gazette is an example of the national government exercising its residual regulatory power in relation to an area in which it holds exclusive law-making power, that is in relation to the *generation* of electricity. Insofar as the proposed new approach relates to *reticulation* or *distribution*, however, the question that has to be asked is whether the proposed approach is consistent with the requirement that such regulation be restricted to norms and standards that provide a framework without prescribing precisely how the reticulation system should work. On the face of it the proposed new Schedule 2 of the ERA probably pushes the boundaries and encroaches too far into municipal powers to regulate the sale of electricity. This requires a technical exploration of whether or not the provisions of the proposed new approach – particularly those dealing with wheeling and reselling - materially affect the way in which municipalities distribute the electricity generated by the licenced generators of electricity. If they do, then it could be argued that the national law intrudes too far into a municipal competence.

5 Next steps

This note is intended to help understand the implications of the proposed new scheme for regulating SSEG. It should be presented to the relevant cities as the starting point for a discussion. It is likely that this will require a high-level legal opinion, bolstered by a technical input on the question of possible intrusion into the area of reticulation/distribution, once the revised Schedule 2 is finally published.