

REGULATORY FRAMEWORK FOR THE ESTABLISHMENT OF NEW GENERATION CAPACITY

1. The key statutes regulating the electricity sector in South Africa are –
 - 1.1. the Eskom Conversion Act, 2001 (which gave effect to the corporatisation of Eskom);
 - 1.2. the National Energy Regulator Act, 2004; and
 - 1.3. the Electricity Regulation Act, 2006; and
 - 1.4. the National Energy Act, 2008.
2. The statute which is key to an understanding of the legal framework for new generation projects is the Electricity Regulation Act, and to a lesser extent the National Energy Regulator Act which sets out the parameters within which the Regulator must make licensing and other decisions.
3. The Electricity Regulation Act specifies the electricity-related activities which must be licensed by the Regulator – such as operation of generation, transmission or distribution facilities, trading, export or import – and a framework for the licence application process. Detailed regulations regarding licensing have been anticipated for many years but to date have not been issued.
4. The Electricity Regulation Act also sets out the powers and duties of the Regulator – most importantly licensing, tariff setting, determination of licence conditions, performance management of licensees and enforcement of licence conditions, and issuing of rules. In terms of the National Energy Regulator Act, members of the Regulator must –
 - 4.1. act in a justifiable and transparent manner whenever the exercise of their discretion is required;
 - 4.2. act in the interests of the Energy Regulator and not in their own or sectoral interests;
 - 4.3. act independently of any undue influence or instruction;
 - 4.4. act in the public interest,and decisions of the Regulator must be taken within a procedurally fair process in which affected persons have the opportunity to submit their views and present relevant facts and evidence to the Energy Regulator; and must be based on reasons, facts and evidence that must be summarised and recorded; and explained clearly as to its factual and legal basis and the reasons therefor.
5. Insofar as a policy-related role for the Regulator is concerned, its key functions are to make rules to give effect to national energy policy; and importantly, to be a co-decision maker on Ministerial determinations regarding the need for new generation capacity.

6. The concept of 'new generation capacity' is introduced in the Electricity Regulation Act, without being defined. Section 34 is the critical provision, and provides for the Minister, with the concurrence of the Regulator (which means by agreement with the Regulator), to make a 'determination' that new generation capacity is required and – simply put – to make it happen.
7. A determination made by the Minister in this context can specify—
 - 7.1. how much new generation capacity is needed;
 - 7.2. the types of energy sources from which electricity must be generated;
 - 7.3. the percentages of electricity that must be generated from such sources;
 - 7.4. that electricity thus produced may only be sold to the persons specified in the determination notice (i.e. can specify the permissible buyer/s);
 - 7.5. that electricity thus produced must be purchased by the persons set out in such notice (i.e. can obligate the identified buyer to purchase the electricity);
 - 7.6. the procurement process applicable to the purchase of that new generation capacity; and
 - 7.7. finally, that the private sector may participate.
8. Section 34(2) also vests in the Minister, certain ancillary powers which are designed to facilitate and expedite the implementation of a determination, such as –
 - 8.1. entering into contracts as necessary to organise tenders and to facilitate the tendering process for the development, construction, commissioning and operation of such new electricity generation capacity;
 - 8.2. to purchase, hire or let anything or acquire or grant any right or incur obligations for or on behalf of the State or prospective tenderers for the purpose of transferring such thing or right to a successful tenderer;
 - 8.3. to apply for and hold permits, licences, consents, authorisations or exemptions required in terms of environmental legislation, for or on behalf of the State or prospective tenderers for the purpose of transferring any such permit, licence, consent, authorisation or exemption to a successful tenderer;
 - 8.4. to undertake such management activities and enter into such contracts as may be necessary or expedient for the effective establishment and operation of a public or privately owned electricity generation business; and

- 8.5. to issue any guarantee, indemnity or security or enter into any other transaction that binds the State to any future financial commitment that is necessary or expedient for the development, construction, commissioning or effective operation of a public or privately owned electricity generation business.
9. Section 34(3) confirms that the Regulator, in issuing a generation licence, is bound by any determination made by the Minister in respect of new generation capacity. So once the Regulator has concurred in a Ministerial determination, the Regulator is arguably bound to license the generation facilities which are selected in a procurement process resulting from a determination.
10. The purpose of section 34, as I have always understood it, is to create an extra-ordinary mechanism that can be invoked by the Minister in circumstances where the 'organic' development of the electricity generation sector is insufficient to meet demand, and a gap is identified which the Minister, as the responsible Cabinet member, is empowered to fill through the procurement of new generation capacity. The wording in section 34 refers to the need for new generation capacity being determined by the Minister "*to ensure the continued uninterrupted supply of electricity*" – implying that if there are sufficient generation projects being licensed and operated without the intervention of the Minister, there would be no need to invoke section 34.
11. Section 34 came into being when the Electricity Regulation Act was enacted in 2006, but that provision in the Act was given retrospective effect to December 2004, in order to regularise the DME's peaking power plant procurement initiative (the two diesel peaking power plants in KZN and Coega in the Eastern Cape). So section 34, in my view, was never intended as an overarching framework for the establishment of all new generation facilities; there is certainly nothing in the Act which requires or implies that a section 34 determination is a precondition to the operation of all new generation facilities. Draft amendments to the Act were published for comment in 2011 or so to provide for a section 34 determination to be required in all circumstances, but were never enacted.
12. Despite this, section 34 arguably has come to be perceived as a necessary first step in the establishment of new generation capacity generally. This perception has caused much uncertainty and is the subject of litigation initiated by the City of Cape Town, where a decision by the court is pending.
13. Another area of regulatory uncertainty which has arguably resulted in delays in project development and implementation relates to the integrated resource plan (IRP). The legislation lacks detail as to the precise status and role of the IRP, and does not spell out precisely how it relates to determinations made in terms of section 34, and generation licensing generally.
14. The IRP is defined in the Electricity Regulation Act as "*a resource plan established by the national sphere of government to give effect to national policy*". The IRP is only referred to in two sections of that Act –

- 14.1. firstly, in section 4 dealing with the powers and duties of the Regulator, where it is stated that the Regulator must *...(iv) issue rules designed to implement the national government's electricity policy framework, the integrated resource plan and this Act*; (which has not been done); and
 - 14.2. secondly, in section 10(2)(g) of the Act, an important provision in practice which states that any electricity licence application required under the Act, must include *evidence of compliance with any integrated resource plan applicable at that point in time or provide reasons for any deviation for the approval of the Minister*.
15. The implication of section 10(2)(g) is that as long as the generation capacity being licensed is provided for in the IRP, no Ministerial approval is required and the Regulator can proceed to licensing. But because there is no prescribed format for the IRP, it may be difficult for a developer or the Regulator to know for certain whether a particular generation facility, or generation capacity which is the subject of a licensing application, is provided for in the IRP or not; and depending on how the IRP is formulated, it could be genuinely unclear whether a project falls in or out of the IRP, especially where there are Ministerial determinations in respect of the same MW.
 16. So the required content of the IRP is not provided for in the Act or any regulations. Nor have rules been issued by the Regulator to give effect to the IRP or national policy. Also, the process of obtaining approval from the Minister for deviation from the IRP has not been regulated or spelt out in any legal instruments – so the decision criteria and the timing of obtaining approval are not available to the public. Also, the precise relationship between section 34 determinations and the IRP is not explicitly dealt with – is the IRP binding, or is it merely a guideline? Can a section 34 determination override the IRP? If a determination is issued which is inconsistent with the IRP, does that mean the allocation of MW in the IRP is no longer available for what the IRP intended?
 17. I think the wording of section 10(2)(g) implies that the IRP can be overridden by the Minister – whether by means of a section 34 determination or by an approval to deviate – but investors and developers would benefit from greater specificity about these aspects. The link between the IRP and licensing policy has caused considerable regulatory uncertainty and is an obstacle to private sector and municipal power generation.
 18. The Electricity Regulations on New Generation Capacity, issued in 2011, give further effect to the section 34 mechanism for establishing new generation capacity, but only insofar as the buyer is an organ of state. Section 34, nominally at least, permits the Minister to decide who must buy the electricity produced from new generation capacity, but in reality it's difficult to imagine a scenario in which the Minister determines the buyer to be someone other than an organ of state.
 19. These Regulations were also not intended to regulate power generation projects that are implemented outside of a section 34 determination, such as own use projects, private sector sales which are

wheeled through the grid, or even public sector projects initiated by an organ of state itself – such as Eskom or a municipality.

20. However, recent proposed amendments to the Regulations muddy the waters by implying that before a municipality can commission a new generation project it must obtain Ministerial approval to do so, and that a Ministerial determination must be issued to give effect to an approved municipal generation project. The effect of these amendments would be to put municipal generation projects in the control of the Minister. In my view there is no authority for these proposed amendments in the Act itself, and they are susceptible to legal challenge. That kind of legal challenge may take years to happen, and in the meantime the regulatory uncertainty will continue.
21. Electricity auctions or bidding programmes such as the REIPP Procurement Programme implemented under the section 34 framework can, as we have seen, result in substantial investment and, if implemented consistently over time and with line of sight on the rolling timetable of the bidding programme, can help to grow local industries, but the key of course is to have a medium to long plan procurement plan and to stick to it – easier said than done but with potentially great results.