Casting Forging and Machining Cluster

Casting, Forging and Machining Cluster of South Africa (NPC)
Reg. No. 2018/054311/08

"Changing the way that South Africa works in the metals industries"

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To: The Department of Mineral and Energy
Att: Mr Matthews Bantsijang (epp@dmre.gov.za
CC: RSA Clusters Group
RSA Clusters and CFMC members
Energy Work Group members

Industrial Stakeholder Representation: Relating to the proposed review drafts of the Electricity Regulation Act and the associated Electricity Pricing Policy

To whom it may concern,

Thank you for the opportunity to provide a response to these important documents to be updated. Ours is an industrial focus, taken from the perspective of users of municipal supplied electricity. opinions, to present advisory inputs, and to engage with NERSA in a value chain focused debate, seeking to improve the competitiveness at all levels of activity in the manufacturing sector.

1. About the CFMC

The Casting, Forging, and Machining Cluster of South Africa NPC (referred to hereinafter as the CFMC) is a nonprofit, industry-led cluster initiative with members. Our agenda is to grow the manufacturing in the core metals industries to meet domestic and export demand, and membership is drawn from manufacturers, service providers, and institutions in the casting, forging, machining and associated manufacturing industries. Initiative members are committed to working together to address the challenges facing them and the local industry in South Africa. CFMC is committed to establishing collaboration alliances with the government on energy related issues, with the aim to stimulate capacity development, improved competitiveness, and economic growth in those local districts that we are active in.

The CFMC and its members are primed to play their part in the revitalization of the South African metals industry. Together the collective bargaining power, great structures and open cooperation of the cluster and its members can forge forth a

South Africa first industry, which rewards locally produced cast and forged core products, improving local manufacturing and contributing toward job creation. CFMC is managed by a Steering Committee of elected leaders.

Our members consist of mini-mills, foundries, forges, heat treatment plants, machine shops, metal processing plants, as well as component manufacturers. Although most are high energy users, supplied through municipal licensees, our members include SMEs. This cluster has a considerable concentration of Municipal supplied industrial users, and serves to provide a significant portion of the manufacturing employment opportunities in the country.

2. Background

We are particularly concerned that the industrial user community has been overly burdened by municipal tariffs that have been poorly structured, are not cost reflective, and include unlawful and unrelated subsidies, that have caused unjustified increases in the cost of production, and that individual manufacturers are unable to off-set by productivity improvements alone. This unwarranted increase in industrial municipal tariffs in conjunction with poor reliability of supply, has in turn led to an increasing loss of competitiveness by the South African companies in the global arena.

Our agenda is simple: we want to increase manufacturing output and increase job retention and job creation. In the quest to do so, we need help from the Local Government authorities where factories are located, to manage their respective electricity businesses well, and to work with us to develop the local industrial economies, by introducing competitive enabling tariffs for us to achieve our goals. In this realm, Local Government electricity tariffs would be appropriately architected to increase domestic consumption of locally produced goods, at competitive prices. Thus, enabling the industrial client-base to generate more work, and create more jobs. The Local Government DSIs would in this way be playing their part as responsible suppliers into the manufacturing value chain.

A large part of the industrial community the manufacturing cluster (estimated to be over 80%), is currently using, and is dependent on, a stable supply of electricity from the national electricity grid, distributed by Local Governments.

The current structures and pricing processes, tax manufacturers upfront for little gain, and serve to destroy the economy. There is little on offer in the Review document, although the changes to be made are exciting, and the document itself is well crafted, to encourage industrial clients that the policies discussed will be implemented as intended. Local Governments, in our view, will need to be incentivised to act in accordance with the legislation and associated policy directives. The evidence is clear that NERSA have not,as yet, been able to reign in and get the attention, and active support of Local Governments, who would appear to be intent on disrupting the ERA and the EPP in support of alternate agendas.

Engagements with NERSA and local government regarding tariffs is confrontational, as opposed to collaborative, which has resulted in parties to this discussion having drawn lines and withdrawn from one another, rather than working together to seek lasting solutions. This behaviour is problematic and has led to market distortions, and the introduction of “competing municipal tariffs", and incoherent signals to potential investors. Urgent attention is needed to normalise structures and tariffs, to avoid further deviant behaviours.

We seek better relationships with NERSA and Local Government, better tariff setting in terms of the EPP, and more standardisation in the setting of industrial tariffs.

3. CFMC Stakeholder Response to the draft ERA

This is an exciting time for the ESI and the changes brought about by this revised version of ERA will enable more competition, better management, and ultimately more sustainable electricity supply. We are hopeful that the Bill, once finalised, will resemble the current draft.

Sect 1 - 5: No comment
Sect 6: We welcome the creation and support for user forums.
Sect 7 - 14: No comment
Sect 15: 1(a) Thank you for dropping the provision for a reasonable margin. This will prepare the way for a more competitive approach to managing costs, and avoid margins being paid despite poor financial reports, and lack of service. It is also better aligned to the Municipal Services Act section 74(2)(d) which stipulates that tariffs must reflect costs reasonably associated with rendering the service, including capital, operating, maintenance, administration and replacement costs and interest charges.
1(d.) Discrimination of any sort, has unintended consequences, resulting from distortions in the relative competitiveness of individual businesses in the respective markets that they serve.
4. This is a positive change. Thank you. .
Sect 16 - 18: No comment.
Sect 19: NERSA has had this authority since changes were introduced in 2007, yet they have been reluctant to impose appropriate sanctions on municipal distributors, and accordingly, have not used their powers to effectively manage compliance with the Act.
Sect 20 - 34 : No comment.

4. CFMC Stakeholder Response to the draft EPP

Policy enforcement is problematic, and we caution that if deviations and non-performance are allowed, the ideals of a fair and just process will continue to be constrained. Market corrections in the ESI will not necessarily suit manufacturing, and free-market outcomes would be at risk of becoming constrained.

The need to catch-up on maintenance and equipment upgrades, will cause a short term spike in costs that should nor be passed onto electricity consumers in the form of tariff adjustments.

For us to achieve our initiatives objectives, we need the suppliers to the manufacturing cluster (including all DSIs) to understand, and in their actions to recognise, the need for continuous improvement, cost reductions as opposed to increases, technology advancements, quality controls, and accountability for one's actions.

In our view, most manufacturing entities are not familiar with the changes that are being introduced, and are oblivious to the potential impact that changes in the policy may have on them. We suggest that NERSA and its partners embark on an awareness drive once the legislative and policy frameworks are updated, in order to create more awareness.

In the response to the proposed policy positions below, we have provided a response to only those paragraphs that we have wanted to comment on. Accordingly, please assume that we have “no comment” related to those paragraphs that are omitted. We are hopeful that the once finalised, the EPP, once finalised, will resemble the current draf, retaining the concepts and principles proposed.

Para 1.3. Key challenges for the EDI

CFMC believes some key challenges pertaining to practices in the municipal distribution of electricity include those identified herein below:

a. Despite the promulgation of the EPP in 2008, the EPP has been largely ignored and is not seen as a policy directive, but rather as rough guide, that has little significance as part of the current municipal tariff determination process.
b. We are particularly concerned with the lack on controls on municipal electricity accounts that:
    i. are not often ring-fenced;
    ii. In the main are not well audited;
    iii. do not have proper customer / tariff categories;
    iv. make broad allowances for inefficiencies; and
    v. independently, do not have insufficient knowledge/information to progress a constructive discussion on cost structures, cost drivers, and unbundling.
c. If the EPP is to be taken seriously, there should be no doubt in the minds of defaulters that NERSA would act quickly to impose sanctions on poor performers, and take disciplinary actions to improve non-performance.
d. The lack of Cost of Supply Studies done at Metro-level, and the acceptance of the fact that smaller municipalities will not be able to comply in the near future, is not an action oriented approach. We are in a hurry, even if the municipal distributors are not. We don’t want dubious time-lines if nothing is to be done about this and other concerns. We fear that the EPP will remain an ineffective document, rather than an implementation enabler.
e. The industrial customers are continuing to fund the municipal excesses, and deserve that respect is given by the State for their role, and accordingly, that they are included in working groups and forums to help the municipal authorities to resolve cost, and delivery concerns, and to help improve service delivery.

f. The ESI and EDI are plagued by theft of electricity, particularly in the municipal space, rendering the electricity distribution functions financially unsustainable. Electricity theft remains largely unaddressed and continues to increase year after year at an alarming rate. Theft manifests itself both in visible theft of electricity (e.g. illegal connections and tampering with electricity metres).
g. High electricity losses of over 20% are not uncommon. Theft manifests itself both in visible theft of electricity (i.e. visible illegal connections in many areas around the country) and the tampering
h. Renewable energy investments in municipal industrial areas under current conditions is problematic for manufacturers, as it is unlikely that they would be willing to commit to private projects, where the minimum guarantee period required by investors and developers (e.g 20 years) exceeds manufacturing limits (e.g. 5 years). A collective investment via the municipalities is an obvious opportunity that in most instances would not be viable as the risk profile for most municipalities are regarded as too high.
i. Many municipalities have focused on social issues, and failed to manage their electricity business, and its associated transmission and distribution infrastructure. Budget cuts and reallocation of electricity revenues to other needs have had the effect of constraining the electricity departments ability to procure replacement equipment ahead of need, or to conduct routine and emergency maintenance of equipment, and to expand electricity services (despite electricity being a municipal cash cow). This action has reduced the reliability and quality of electricity supply, creating concerns that the tariffed infrastructure is unable to meet minimum technical, health and safety and performance standards required.
j. Few municipalities levy surcharges in line with the provisions of the MFPFA. However, Nersa continues to approve tariffs, despite them containing excessive surcharges.
k. The Regulator is not above rebuke. They are implicated in all the challenges mentioned, and by not doing enough to correct deviant behaviour, have played a role in condoning those same deviant behaviours, by not taking corrective actions to sanction, discipline, or otherwise correct the situation.
l. Municipalities are argued to have the constitutional right to reticulate electricity within their area (current challenge by Salga).If implemented, such rights could lead to the systematic introduction of surcharges in line with the MFPFA.

<u>Para 2.1 General Tariff Principles: </u>Current text

Whilst the principals are in general good, they do need to be reviewed to ensure that the words have relevant meaning,as intended.

a) …the setting of prices, charges, tariffs and the regulation of revenues must enable an efficient licensee to recover the full cost of its licensed activities, including a reasonable margin or return.

Comments and proposal

a) Efficient (efficiency) is a term that is used widely in the EPP. Experience shows that the interpretation, meaning and understanding of "efficiency" differs between readers.The term "efficient" needs to be defined in the EPP for clarity to the diverse group of readers.
b) "Reasonable margin or return" is replaced in the ERA with "reasonable return commensurate with the risk of the licensed activity";

Para 2.2. Introduction:

This section reflects a theoretical model which is far removed from the South African reality in which South Africa's industrial base and specifically the industry behind municipal borders, is currently being abused by the EDI. It continues to be pressured to carry the increasing burden of mismanagement in the EDI. .

Para 2.2: Policy Position 1: Revenue Requirements
CFMC are in agreement with the principle, but are concerned that NERSA has not yet (to-date) developed an asset valuation methodology

Comments and proposal:

Given the current situation of poorly maintained infrastructure across multiple municipalities, there is a need for tight financial controls to limit the exposure of consumers to pay for negligence and mis-appropriated funds.

Para 2.3: Policy Position 2: Cost reflectivity
…"the energy costs for a particular customer category"

Comments and proposal
CFMC does not understand the motivation as to why the clause "the energy costs per customer category" has been deleted as part of the "cost reflectivity Policy Position. There seems to be a casual change in the direction of the policies toward the less apt term "tariff category", which subliminally permeates the thinking. In our view great care needs to be taken to ensure that the term "customer categories" and its importance as a link to the provision of a related service that is efficient, and the business of providing value to various customer groups. This is the appropriate underlying principle that should not be lost on the implementers of the policy, the writers thereof. Or the various electricity value chain stakeholders. Fears of discrimination between categories might be real concern, but should be dealt with in appropriate forums, whenever it occurs.

In our view customer category and tariff category are not one and the same, and are not interchangeable. We accept that both terms may be relevant as a crucial part of the tariff determination process, in which case, neither should be excluded.

Para 2.7: Policy Position 6: Special Products

Comments:

a) We are in agreement with the principal applied, that product offerings should be differentiated, as needed. However as an industry stakeholder, CFMC does not, however, understand the need for differentiation in the DSI.

b) More is to be done to educate consumers as to what products are available, and under what circumstances they might apply. CFMC are of the view that proposed arrangements could lead to discrimination and we believe that that optimal tariffs reflecting efficient cost should be available to all consumers within a certain customer category.

<u>Para 5.1 and 5.1.3: Policy Position 11:</u>

a) "....in the case where renewable support mechanisms are insufficient and State targets for renewables are thus not reached, renewables could be introduced at a price premium relative to non-renewables, subject to approval…." (Para 5.1 (b))

<u>Comments</u>

a) CFMC is concerned that the availability of alternate renewable support mechanisms is being constrained by State procurement and politics. There have been undue delays to implement alternate renewable options, despite a shortage of generation capacity at Eskom. This has had the effect that we are already behind State targets and it is well known that there is already a shortage of alternate renewable mechanisms. Furthermore, there is a huge commitment cost being incurred by Eskom that has signed off-take agreement, and committing to pay expensive standby costs, which could be expected to decrease once usage of this capacity is optimised.Under these conditions, a "price premium" should not be considered as the only variable.

<u>Para 5.1.3 : Policy Position 12: Wholesale Energy Price Level</u>

If CFMC understands this correctly, this policy is aimed to ensure that costs and revenues will be aligned by a process similar to the RCA process that ESKOM uses to adjust cost projections, and actual costs.

<u>Comments and proposal</u>

The current RCA process is cumbersome, and results in extraordinary pressures on tariffs. An alternate process is recommended to ensure that there are more frequent corrections, reflecting monthly changes.

<u>Para 5.3.2 Policy Position 14: Standby Capacity Charges</u>

CFMC agrees with the principle, but does not agree with the intent.

<u>Comments and proposal</u>

Care should be taken to ensure that the effects of competitive pricing are not diluted, and that discriminatory practices ate stopped. NPAs in our experience are inherently discriminatory.

The standard tariff system based on cost of supply per customer category should be a sufficient mechanism for price determination and any other agreement will not be consistent with the basic provisions under section 15 of the ERA. At least there should be a provision that NPA's will not be subsidised by other consumers.

Para 8.1: Policy Position 23: Tariff Level and Structures

In the text, it is stated that "a COS study should not be used to justify costs, but to allocate costs based on approved (allowable) revenue".

Comments

CFMC agrees with the principle as stated. Alas, although the policy is set out, it is high level, stating that "tariffs shall recover allowable revenue/revenue requirements for distributors". It remains unexplained as to how Nersa will determine such revenues, if not through a COS study "including efficiency tests". These statements have created a conundrum, to be resolved through a fresh annunciation of what is planned.

Furthermore if costs are not evaluated to justify and confirm their relevance to a particular process, how can they be allocated?

The amended policy does not provide guidance as to how tariffs per customer category would be determined. By not attend to rectifying this concern, the policy may cause the exact problem that the revision seeks to solve: i.e. cross-subsidising of customer categories and discrimination.

Note: Nersa's existing "Cost of Supply Framework" sets out mechanisms to determine the allowable revenue for distributors and also the tariff setting per customer category once the allowable revenue has been determined.

Para 8.2: Policy Position 24: Cost of Supply Studies

a) "Electricity distributors shall provide CoS studies to propose new tariffs, special pricing and products or tariff structure changes to NERSA and submit an updated CoS study at least every 5 years to inform NERSA on the current customer base..".

Comments

We are concerned that this policy has not been implemented despite prior policy statements, and NERSA guidelines.

Please refer also to comments re: para 8.1 (above). If the COS study is not the basis of Nersa's tariff determination, what alternative method does the EPP provide for? Given that tariffs should only include efficient cost, it is also unclear on how to deal with inefficiencies and how Nersa should ensure inefficiencies do not become part of the tariffs

Para 8.3: Policy Position 24: Refurbishment and Maintenance Backlog

Comments:

The requirement for licensees to put strategies in place without timelines is too loose. It would serve to settle the minds of all parties (including industry stakeholders) if the extent of the problem had been quantified as soon as possible, to inform a central intervention management office to register the problem area, prioritise where effort will be best deployed, and to strategise as to how this will be done using locally manufactured equipment.

Para 8.5: Policy Position 25: Customer Categories

The review document is somewhat confusing and has led to various related comments being made elsewhere. CFMC is in agreement with the principles applied.

Comments and proposal

There are complex mathematical and technical assessments required for each customer category, making tariff setting a more exact science, rather than a random grouping, of like customers if the policy proposed is read correctly.

More work is needed to integrate the references to customer categories into the heart of the document. Cost reflectivity (para 2) should explicitly state that tariffs should be **cost reflective per customer category**.

Para 8.6: Policy Position 26: Cost Drivers and Components

Comments:

a) Unbundling of the costs makes sense, and the components proposed are logical.

b) There is no reason to delay some of these actions, and it is anticipated that work to develop a framework and to define the details of what goes into each component is well advanced. This needs to be made a NERSA priority.

Para 8.15: Policy Position 35: Retail Energy Charges

CFMC agree in principle

Comments:l

Those municipalities that are **not** currently providing a TOU tariff should be identified, so that everyone is aware that the electricity forums in those areas should be anticipated to be working on defining this tariff within the proposed timeline.

This proposed Policy Position provides an unacceptable grace period to municipalities that have blatantly disregarded prior policies.

Para 8.16: Policy Position 5: Voltage and Position Differentiation

It is criminal that the adjustment changes as recommended in prior versions of the EPP have not been implemented as directed. Instead the differential for industrial tariffs has continued to increase, and has continued to place our manufacturing production cluster at risk. This needs URGENT attention, in the form of a clear policy directive for implementation in the 2022/23 tariff guidelines.

Para 8.20: Policy Position 37: Refurbishment and Maintenance

Comments ad proposal:

a) The manufacturing producers do not have the margin to absorb additional costs. This correction to restore the infrastructure, should be funded from the fiscus, or by investors.

b) Technical and Procurement Oversight is needed.

    i) The technical capability of Eskom and municipalities has been eroded. If technical regulation is not introduced we are unlikely to achieve the desired financial outcomes, unless help is provided to empower the procurement of experience and know-how in the respective areas requiring refurbishment and maintenance.

    ii) If maintenance is done well, goods and services are procured from local suppliers (and products are made locally)l manufacturers will benefit, which will in turn benefit the local community, increase tax revenues, etc.

Para 8.21: Policy Position 39: Distribution Losses and Bad Debt

Comment:It is clear that certain municipalities are unable to manage tier losses and bad debt. Alternate support mechanisms need to be established (presumably by NERSA) to develop the municipal human capacity to enable them to be more business focused, dynamic, and accountable.

Para 8.24: Policy Position 44: Municipal Surcharge on Electricity

CFMC supports this principle

Comments and proposal

a) We believe that the municipality needs to grow the local economy, rather than seek to tax electricity users. CFMC proposes that this policy should explicitly state that the income from tariffs determined by Nersa cannot be used for any purpose other than for (efficient) expenses concerning the electricity distribution function.
b) The Nersa tariff setting methodology currently allows a 15% margin that can be added to the cost, and make up a part of the tariffs charged. This margin cannot be not be justified under any circumstances. As it has no part of the cost structure, a margin has no purpose in funding the distribution business and is in effect another

"surcharge" on tariffs. CFMC proposes that the margin is **explicitly disallowed** in future tariffs.

Para 8.25: Policy Position 43: Cross-subsidies

CFMC supports this principle.

Comments and proposal

There is a common understanding of the social needs, but a very divergent view on how to address it. Our view is that manufacturers should be competitive, empowered by a competitive electricity industry, and held to account to drive economic growth and with it, job creation.

Para 10.21: Policy Position 60: Emergency Measures / Energy Shortages

Comment and proposal: Load curtailment is a useful tool to be used to encourage industrial users to reduce load in time of need. CFMC is keen to collaborate with municipalities to facilitate the rollout of such a programme in industrial areas.

Para 10.22: Policy Position 61: Energy Efficiency

Comment and proposal: Energy use optimisation and efficiency are an imperative for South Africa to become more competitive. Incentives are needed. CFMC is keen to collaborate with municipalities to facilitate the rollout of such a programme in industrial areas.

We hope that out inputs will help DMRE to draft a better draft Bill and associated policies.

Regard

Regards
Steve Jardine
Managing Director
12 March 2022