UPDATE ON EDI RESTRUCTURING
Presentation to the 61st AMEU Convention 2008
Buffalo City
Phindile Nzimande
CEO: EDI Holdings
27 October 2008
Presentation Outline

- Challenges facing the Electricity Distribution Industry (EDI)
- Solutions to the industry challenges
  - EDI stabilisation
  - EDI Restructuring/Consolidation
- Key restructuring progress to date
- High-level Strategic Implementation Plan
- Policy and regulatory consideration
- Conclusion
CHALLENGES FACING THE ELECTRICITY DISTRIBUTION INDUSTRY
Currently South Africa operates in the traditional mode of vertical integration with financial and physical flows following the same path.
Key Challenges Facing the EDI

- Current industry structure is highly inefficient owing to fragmentation
  - Absence of economies of scale in respect of investing in assets, sharing of facilities, services, people development

- Inadequate maintenance of networks
  - Supply interruptions cost to the Economy: R2.9 bn to R 8.6 bn p.a.**

- Inequitable treatment of consumers across the country
  - Significant variance in average tariffs by Distributors:
    - Range*: 19c/kWh – 71c/kWh (medium sized business)
    - 16c/kWh – 60c/kWh (domestic customers)

- Inconsistent Electrification Performance
  - Access to electricity: ~73 % (National)

- Slow and Inconsistent Roll-Out of FBE
  - Reliability of supply and the ability of the distributors to offer a basic and secure supply to low income households differs markedly across the country
  - Current rollout is less than 40% of targeted community

# NERSA Report 2007: EDI Maintenance Perspective

<table>
<thead>
<tr>
<th>Distributor</th>
<th>Reliability</th>
<th>Control</th>
<th>Maintenance</th>
<th>Networks</th>
<th>Skills</th>
<th>Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eskom Region</td>
<td>G</td>
<td>VG</td>
<td>VG-E</td>
<td>G-VG</td>
<td>VG-E</td>
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<tr>
<td>Metro 1</td>
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<td>Metro 2</td>
<td>G</td>
<td>VG</td>
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<td>G-VG</td>
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<td>NI</td>
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<td>Metro 3</td>
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<td>Metro 4</td>
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<td>NI</td>
<td>NI</td>
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<td>G</td>
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<td>Metro 5</td>
<td>NI</td>
<td>NI</td>
<td>G</td>
<td>G-VG</td>
<td>NI</td>
<td>NI</td>
</tr>
<tr>
<td>Municipality 1</td>
<td>NI</td>
<td>NI</td>
<td>G</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
</tr>
<tr>
<td>Municipality 2</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
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<td>G</td>
<td>NI</td>
</tr>
<tr>
<td>Municipality 3</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
</tr>
<tr>
<td>Municipality 4</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
<td>NI</td>
</tr>
</tbody>
</table>

E=Excellent; VG=Very Good; G=Good; NI=Needs Improvement

Source: NERSA Independent Technical Audit
Refurbishment and Maintenance of EDI assets


- Required Expenditure (Accumulated)
- Estimated Expenditure (Accumulated)
- Estimated (Acc.) / Required (Acc.) (%)

Within 6 years we will have fallen behind by a further 4½ years!

Estimated Refurbishment Backlog: R21.1 Billion*

Note: Both Required and Estimated figures are approximations modelled by EDI Holdings. They do not necessarily reflect planned or actual expenditure by current asset owners; *Maintenance backlog not included
Estimated Refurbishment and Maintenance Backlog per RED area

Total Estimate R 27.4 billion

<table>
<thead>
<tr>
<th>RED</th>
<th>Eskom Backlog</th>
<th>Municipal Backlog</th>
<th>Total Backlog</th>
</tr>
</thead>
<tbody>
<tr>
<td>RED ONE</td>
<td>R 2,142,464,295</td>
<td>R 1,709,113,950</td>
<td>R 3,851,578,245</td>
</tr>
<tr>
<td>RED TWO</td>
<td>R 3,218,216,561</td>
<td>R 1,914,157,203</td>
<td>R 5,132,373,764</td>
</tr>
<tr>
<td>RED THREE</td>
<td>R 1,332,224,178</td>
<td>R 854,071,847</td>
<td>R 2,186,296,025</td>
</tr>
<tr>
<td>RED Four</td>
<td>R 4,396,339,787</td>
<td>R 2,016,808,611</td>
<td>R 6,413,148,398</td>
</tr>
<tr>
<td>RED FIVE</td>
<td>R 2,247,544,076</td>
<td>R 1,910,806,572</td>
<td>R 4,158,350,649</td>
</tr>
<tr>
<td>RED SIX</td>
<td>R 3,884,894,505</td>
<td>R 1,742,505,409</td>
<td>R 5,627,399,914</td>
</tr>
<tr>
<td>TOTAL</td>
<td>R 17,221,683,403</td>
<td>R 10,147,463,592</td>
<td>R 27,369,146,995</td>
</tr>
</tbody>
</table>
SOLUTIONS TO THE INDUSTRY CHALLENGES

1. Industry Stabilisation
2. Industry Restructuring/Consolidation
1. Industry Stabilisation
In the quest to find a holistic solution to the electricity supply challenges faced by the country from early 2008, the Presidency through ASGISA cmae to conclusion that:

- The current state of the distribution infrastructure will not be able to contribute meaningfully to the critical power conservation program and the general challenges the country faces
- Consequently, a ‘crack’ project to put together a holistic EDI business plan and execution strategy to address the electricity distribution industry infrastructure was established
- This project is led by EDI Holdings and has since been called the Approach to Distribution Asset Management (ADAM)

**ADAM** seeks to:

- Ensure a coordinated and an immediate increased investment by operators in network planning, network maintenance and refurbishment
- Identify highest improvement opportunities
- Implement a holistic and standardised asset management strategies supported by appropriate international best practice maintenance approaches
- Identify and develop strategies to address maintenance, refurbishment and funding gaps
ADAM’s immediate priority will be the entities audited as well as the 2010 Soccer World Cup host cities. These cities include:

<table>
<thead>
<tr>
<th>City of Cape Town (2010 Host City)</th>
<th>Mangaung (2010 Host City)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ekurhuleni</td>
<td>Msunduzi</td>
</tr>
<tr>
<td>eThekwini (2010 Host City)</td>
<td>Nelspruit/Mbombela (2010 Host City)</td>
</tr>
<tr>
<td>Nelson Mandela Bay Metro (2010 Host City)</td>
<td>Polokwane (2010 Host City)</td>
</tr>
<tr>
<td>Tshwane (2010 Host City)</td>
<td>City of Johannesburg (2010 Host City)</td>
</tr>
<tr>
<td>Rustenburg</td>
<td>Emfuleni</td>
</tr>
</tbody>
</table>
2. Restructuring of the Electricity Distribution Industry
Having considered technical submissions on:
- The financial viability of the different RED models;
- The institutional and governance arrangements for the REDs; and
- How the various models respond to the restructuring policy objectives.

The Cabinet approved the following:
- That 6 wall to wall REDs be implemented;
- That the REDs be established as public entities and be regulated according to the PFMA and the Electricity Regulation Act;
- That Eskom becomes a shareholder in the respective REDs for a transitional period and that they reduce their shareholding over time;
- That DME, through EDI Holdings, will oversee and control the establishment of REDs;
- That a roadmap will be put in place to move from the current scenario into the future industry structure;
- That a strategy needs to be developed to deal with capital investment requirements for the REDs;
- **That EDI Restructuring legislation will be introduced; and**
- That a National electricity pricing system will be developed.
6 Wall-to-Wall RED Boundary Map

Provincial Boundaries

- RED 1
  - Cape Town Metro

- RED 2
  - City of Johannesburg Metro
  - Lesotho

- RED 3
  - Nelson Mandela Bay Metro (Port Elizabeth)

- RED 4
  - City of Tshwane Metro (Pretoria)

- RED 5
  - Ekurhuleni Metro
  - eThekwini Metro (Durban)

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What are REDs? (…1)

- New companies into which both municipalities and Eskom will transfer their electricity distribution businesses
- Shareholding to be split between Eskom, National and Local Government
  - NOT a privatisation exercise
- Service providers of choice to the service authorities:
  - Municipality remains service authority and RED becomes Service provider
  - REDs will collect surcharges in accordance with the Municipal Fiscal Powers & Functions Bill on behalf of the municipalities and pay it over to them
  - REDs will pay dividends to shareholders subject to financial performance
  - Relationship between RED and municipalities to be governed through the Service Delivery Agreement as contemplated in Section 81 of Municipal Systems Act
  - Streamlined relationship reducing duplication and creating clear accountability
  - Better regulation with role clarity between service authorities, service providers and the National Energy Regulator of South Africa

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What are REDs? (...2)

- Decentralised geographical service delivery

- Enable Government’s social policy, e.g. electrification and free basic electricity
  - Single institution
  - Focus on service
  - Consistency in operating policies and application across RED geographical area
  - Development and application of best practices

- Support Government’s objective of universal access to electricity by 2012

- Become more efficient and able to service customers equally well, at realistic tariff levels through:
  - Lower Interest charges due to improved access to capital markets
  - Efficiencies in “non-payroll” related areas, i.e., general costs
  - Accounts Receivable. Using best practices in a reasonable, good faith effort approach to reduce bad debt accounts
Protection of Municipal Revenue Stream

- Municipalities will continue to derive income from electricity sales within their area of jurisdiction
  - By contract
  - Municipal Fiscal Powers and Functions Act (Act 12 of 2007)

- The income will be based on the current audited revenue generated from electricity sales and transferred to the municipality to support other services.

- The method through which municipalities will receive a continued revenue stream from electricity sales would be through:
  - A surcharge to customers on electricity sales
  - Dividends from the relevant RED, subject to financial performance and within the approved policy of the relevant RED

- Surcharges collected by the RED will be paid over to the relevant municipality on a basis agreed to between the relevant municipality and the RED.
Key progress to date…(1)

- Regional project governance structures to ensure broader participation by all municipalities in line with the 6 wall to wall Cabinet decision have been established:
  - Sponsors Committees (6)
  - Steering Committees (6)
  - Regional Engagement Forums (6)
  - Regional Transitional Labour Relations Structures (6)

- 137 (out of 187) Municipalities have to-date signed the Accession to Cooperative Agreement;

- Substantive progress of critical mass participants on Section 78 and ring-fencing:
  - Eskom, four Metros and 10 other municipalities are ringfenced
  - 3 Metros and 6 other municipalities have completed MSA S78
  - Over 65 municipalities have been approved funding for s78 and ringfencing

- Eskom Distribution has realigned its business along the RED boundaries

- A Business Processes and Systems Blueprint for the REDs has been developed

- Future industry Wires and Retail Blueprints have also been completed

- Transfer Agreement and Placement & Migration Agreements have been adopted by the TLRS

- R1,2 billion allocated for 3 years through the MYPD and is being disbursed to ensure readiness
The project to quantify various policy options relating to asset valuation, compensation, shareholding and governance, as well as impact analysis is being finalised.

- EDI Holdings is currently designing structured engagements with key stakeholders in order to ‘negotiate’ the terms of business transfer.

Substantive inputs provided on various policies/legislations:

- RED Establishment Bill
- Asset Transfer Framework (limited consultation stages)
- Constitutional Review Committee Process
- Policy process on the system of Provincial & Local government

A Strategic Implementation Plan (SIP) focusing on National goals; The Deal; and Transition Path has been developed.
HIGH-LEVEL STRATEGIC IMPLEMENTATION PLAN
### Overview of the Strategic Implementation Plan

The Strategic Implementation Plan sets out the framework within which EDI restructuring will be implemented, providing clear direction in respect of three key questions:

<table>
<thead>
<tr>
<th>Key Question</th>
<th>Answer</th>
<th>Types of Content Addressed in the SIP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1.</strong> What is our Destination?</td>
<td><strong>EDI Restructuring</strong></td>
<td><em>National Goals</em></td>
</tr>
<tr>
<td></td>
<td>- National Goals for EDI</td>
<td>- Definition of National Goals</td>
</tr>
<tr>
<td></td>
<td>- End-state of six wall-to-wall REDs</td>
<td>- Formulation of EDI Scorecard through translating National Goals into metrics and targets</td>
</tr>
<tr>
<td><strong>2.</strong> How will we get there?</td>
<td><strong>Transition Path</strong></td>
<td>- EDI end-state architecture</td>
</tr>
<tr>
<td></td>
<td>- Assuming voluntary restructuring mode</td>
<td>- RED design and positioning in industry value chain</td>
</tr>
<tr>
<td></td>
<td>- Mitigation of risk and uncertainties by “staging” approach</td>
<td>- Oversight role during transition and end-state</td>
</tr>
<tr>
<td><strong>3.</strong> Conditions for Success?</td>
<td><strong>The Deal</strong></td>
<td><strong>Overview of current approach and respective challenges</strong></td>
</tr>
<tr>
<td></td>
<td>- Agreement by asset owners and national government on preliminary</td>
<td><strong>High-level description of a staged Transition Path</strong></td>
</tr>
<tr>
<td></td>
<td>list of 23 issues</td>
<td><strong>Key decision points to be considered en route to end-state</strong></td>
</tr>
<tr>
<td></td>
<td>- Legislative frameworks and other codification to cement agreements</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>*Preliminary list of 23 Issues of “The Deal”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>*Point of view on how to develop The Deal, based on analyses across the 23 Issues</td>
</tr>
<tr>
<td></td>
<td></td>
<td>*Codification tools and sequence of codification to implementing The Deal</td>
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</tbody>
</table>
National Goals
EDI Holdings has set about defining in a more precise manner the aspirations for the electricity distribution industry restructuring drawn from the Energy White Paper and EDI Restructuring Blueprint.

**Energy White Paper**
- "Government believes that distribution industry restructuring should be undertaken in order to:
  - ensure agreed-to **electrification targets** are met
  - provide **low-cost electricity**
  - facilitate better **price equality**
  - improve the **financial health of the industry**
  - improve **quality of service and supply**
  - foster proper **co-ordination** of operations and investment capital
  - attract and retain **competent employees**"

**EDI Restructuring Blueprint**
- "The EDI has five key objectives:
  - to provide **low cost electricity** to all consumers, with equitable tariffs for each customer segment
  - to provide a **reliable and high quality supply** and service to all customers…
  - to meet the country’s **electrification targets** in the most cost-effective manner…
  - to meet the legitimate employment, economic and social interests of all **employees** in the sector, and ensure their safety
  - to operate in a **financially sound and efficient manner**…"

In addition, the Blueprint states that:
- "All contributors of assets to the RED should be **compensated**," and
- "**Local Government should not suffer financially** from the creation of the REDs"
- “Once established, the REDs have the capacity to achieve significant improvement in cost **efficiency** …”
The National Goals must achieve objectives on three levels

- **National Outcomes**
  - Impact of restructuring on citizens

- **Industry Outcomes**
  - Health and level of performance of the industry

- **Restructuring Principles**
  - Restrictions within which restructuring must occur
Certain goals emerged from the analysis of the government policy papers. These can be grouped into three categories: National Outcomes, Industry Outcomes and Restructuring Principles.

### National Outcomes
- Impact of restructuring on citizens
  - Universal household access to electricity
  - Reliable and high quality supply and service
  - Affordable electricity
  - Equitable tariffs

### Industry Outcomes
- Health and level of performance of the industry
  - Financially viable and sustainable industry
  - High levels of efficiency and productivity
  - Sound investment strategy

### Restructuring Principles
- Restrictions within which restructuring must occur
  - Protection of existing conditions of employment for staff transferred to REDs
  - Fair valuation of assets contributed to REDs
  - Preservation of municipal revenue streams

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**National Goals and Categories**

- **• Health of EDI**
  - Performance level of EDI that delivers restructuring objectives

- **• Economic protection of stakeholders directly affected by restructuring**

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The EDI Transaction/Deal
Strategic Objectives of the transaction

The strategic objective of the transaction is to consolidate the electricity distribution industry of South Africa through merging the EDI assets of Eskom and municipalities into 6 financially viable REDs in order to:

- Derive operating and financial synergies and economies of scale in the industry
- Enhance security of supply
- Provide ease of industry regulation
- Promote the desired investment in infrastructure and maintenance

The envisaged outcome of the transaction to the South African citizen will be:

- Reliable and high quality supply and service
- Equitable treatment of customers across the country
- Streamlined electrification and free basic Electricity programme
Conditions for Success: Establishing the Deal Framework

What do we need to reach agreement on?

List Issues of “The Deal”

- The Deal is a set of interdependent agreements on issues between asset owners and stakeholders
- There are 23 Issues of The Deal that have been identified so far
- Five of these Issues can be considered to be Deal-Breakers: protection of surcharges, compensation, credit rating, asset transfer, governance representation
- The list of Deal Issues requires completion and verification

How do we advance The Deal?

Develop Agreement on all Issues

- Use analytical methods to assess and prioritise the Deal Issues, e.g.,
  - Interdependency of issues
  - Need for standardised resolution
- Plan the negotiation strategy and negotiate with asset owners

How do we conclude The Deal?

Codify and Implement

- At present 13 key codification instruments are available or anticipated
- These instruments can be categorised into three functional phases
  - Establishment of Framework agreements through Regulations
  - Agreement on transactions to establish the RED
  - Agreements between RED and other parties
Deal issues to be resolved…(1)

<table>
<thead>
<tr>
<th>Issue</th>
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<tbody>
<tr>
<td>1) Protection of Energy Trading Surpluses and Surcharges</td>
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<tr>
<td>2) Stranded Assets</td>
</tr>
<tr>
<td>3) Compensation</td>
</tr>
<tr>
<td>4) Control Over Customer Interface</td>
</tr>
<tr>
<td>5) Switch-Off Capability (Credit Control)</td>
</tr>
<tr>
<td>6) Tariff Consistency in Area of Jurisdiction</td>
</tr>
<tr>
<td>7) Credit Rating Guarantee</td>
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<tr>
<td>8) Lighting</td>
</tr>
<tr>
<td>9) Rollout of Social Development Plan</td>
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<tr>
<td>10) Provide Support for Delivery of IDP</td>
</tr>
<tr>
<td>11) SLA/ SDA</td>
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<tr>
<td>12) Return of Assets in Case of Failure</td>
</tr>
<tr>
<td>13) Retention of Debtors’ Book</td>
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</table>
# Deal issues to be resolved ...(2)

<table>
<thead>
<tr>
<th>Issue</th>
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<tbody>
<tr>
<td>14) Transfer of Assets and Liabilities</td>
</tr>
<tr>
<td>15) Board and Governance Representation</td>
</tr>
<tr>
<td>16) Continuity of Service Delivery</td>
</tr>
<tr>
<td>17) Access to Fibre Optic Cables for Communication</td>
</tr>
<tr>
<td>18) Right to Determine Tariffs</td>
</tr>
<tr>
<td>19) DSM Support Through RED</td>
</tr>
<tr>
<td>20) Key Industrial Customers</td>
</tr>
<tr>
<td>21) Eskom to Divest From RED After Transitional Period</td>
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<tr>
<td>22) Shared Services Centre</td>
</tr>
<tr>
<td>23) Harmonisation of Conditions of Service</td>
</tr>
</tbody>
</table>

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### Issues Management Matrix

Issues with high levels of contention and which can easily be standardised should be tackled first as these will have the maximum impact on the restructuring process.

<table>
<thead>
<tr>
<th>Level of Contention</th>
<th>Standardisation Feasible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low to Medium</td>
<td>No</td>
</tr>
<tr>
<td>High</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Issues by Contention and Standardisation**

- Mediate
- Policy Solution
- One-on-One Negotiation
- Make Recommendation

Targeting these issues, preferably by policy implementation, will create a solid foundation on which the future restructuring steps can be based.
Nature of the transaction

- The transaction is between Eskom distribution and Municipal electricity distribution businesses on one hand and the REDs or proxy thereof on the other.

- Eskom distribution and municipalities will transfer their electricity distribution assets, liabilities and employees to the REDs.

- REDs will be new companies jointly owned by Eskom, National and Local Government.

- The envisaged transaction has elements of both a merger and a legislated transfer of assets.
The Deal Framework

Influential Shareholders

Local and National Government / Shareholders of CAO

EDI Holdings (EDIH)

Facilitator

Future RED or Proxy for RED

Influential Shareholders

National Gov. / Shareholders of REDs

Signatories

Current Asset Owner (CAO)*

EDI assets

Compensation/Conditions

Signatories

Legislative Environment

Facilitates

provide means to RED?

provide returns?

receive pay-out?

re-invest?

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Proposed Guiding Principles

- We are still in the process of developing guiding principles which will amongst others include:
  - EDI business valuation methodology to be transparent;
  - Current asset owners NOT to be adversely affected;
  - No windfall gains
  - Shareholding in the REDs to be in proportion to business value;
  - Customers should not pay twice
  - Minimal impact on employees.

An exhaustive list is under refinement and will be agreed to with all stakeholders prior to deal negotiations commencing.
Way Forward on the EDI Transaction/Deal

- All analyses necessary to resolve stakeholder concerns has been completed
- Structured engagement/negotiations with relevant stakeholders
- Deal codification
- Implementation
- Post merger integration management
Policy & Regulatory Considerations
What would help fast-track restructuring?

- **RED Establishment Bill**
  - DME has made significant advances in the drafting of the RED Establishment Bill.

- **Addressing the voluntary mode of restructuring**

- **The Deal**
  - The project to quantify various policy options relating to asset evaluation, compensation, and impact analysis is being finalised

- **Asset Transfer Framework for Municipalities**
  - National Treasury issued an Asset Transfer framework exemption from s.14 of the MFMA in April 2007
  - NT has also gazetted regulations for Asset Transfer in terms of s.14 of the MFMA

- **The Municipal Fiscal Power & Functions Act**
  - The Municipal Fiscal Powers and Functions Act, 2007 (Act No 12 of 2007) was passed in September 2007 and will, amongst others, legislate the municipal surcharge;
  - Supporting regulations need to be accelerated

- **Industry Regulation**

Finality of these policy/legal instruments will go a long way in accelerating RED creation
CONCLUSION
Conclusion

- The electricity challenges facing both the EDI and the ESI as a whole call for an integrated and holistic approach to the solution from all industry players, business and citizens of this country
  - EDI Holdings is an active member of the National Electricity Response Team dealing with mostly supply side challenges and demand side management initiatives
  - Electricity distribution industry stabilisation is now more urgent than ever
  - The restructuring of the electricity distribution industry should be accelerated to avoid undesired future challenges

- An enabling legislative environment is key to the successful implementation of the restructuring mandate

- Concluded work on resolving major stakeholder issues and are currently designing structured engagements with key stakeholders to interrogate proposals on these

- We are grateful for the opportunity to provide an update on the EDI Restructuring process to the AMEU Convention

- Lets get ready to negotiate and make the EDI work optimally
THANK YOU

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