EDI Restructuring: The Legacy, the Lessons and the Future

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Introduction

• Over twenty years have passed since the idea of restructuring the EDI was first raised and debated by industry stakeholders;
• The journey to restructure and consolidate the electricity distribution industry (EDI) has been an arduous and challenging, yet exciting one;
• We did not travel the road alone, but had the fortune of the companionship of a myriad of stakeholders, for whose support and counsel we remain ever-grateful;
• During the period 2000 to 2001 and 2005 to 2006 extensive debate took place in respect of the approach to the EDI restructuring;
• During 2006 Cabinet reconfirmed their decision to stay with the 6 RED model as an end state model;
• Meaningful progress in restructuring the EDI was unlikely without a Constitutional change.
Run-up to the “Fall”

- On 18 November 2010, during the 6th Annual General Meeting of EDI Holdings, the Honourable Minister Dipuo Peters, Minister of Energy, engaged with the EDI Holdings Board of Directors;
- The Board indicated to the Minister that EDI Holdings had made significant progress in respect of the EDI restructuring preparation and readiness activities;
- The EDI restructuring programme consisted of 897 registered projects, inclusive of the projects dependant on external inputs;
- EDI Holdings had completed 72% of the registered projects which confirms the significant progress towards the establishment of the envisaged REDs;
- The Minister indicated to the Board that she was in consultation with her colleagues and some stakeholders, on matters including the future of EDI Holdings;
- On 08 December 2010, the Cabinet passed a resolution to close EDI Holdings on 31 March 2011 and to discontinue the process of creating the REDs.
EDI Restructuring History

- DMEA & Permanent Finance Liaison Committee Report
- National Electrification Forum (NELF) Report
- Electricity Working Group Report
- Options for an Electricity Market in South Africa
- Key Industrial Task Team Report
- Electricity Restructuring Inter-Departmental Committee (ERIC) Report
- Energy White Paper
- EDI Restructuring Blue Print Approved by Cabinet 2001
- Cabinet Reconfirm RED Model
- July 2005 RED1 Established
- Cabinet Announce Review
- EDI Handover Report

Timeline:
- 78
- 92
- 93-94
- 96
- 96
- 96
- 97
- 99
- ’01
- ’05-’09
- ’10-’11
The Legacy

• Unbiased industry analysis and research was performed that revealed a far more comprehensive picture of the state of the EDI than had ever been available;

• Many of the EDI assumptions were proved, some perceptions changed and many new and disturbing facts emerged that pointed to the need to accelerate the reform process;

• Better understanding of the challenges faced by the EDI which in turn directly contributed to a greater willingness to address amongst others the funding and resources challenges;

• Today the industry has a comprehensive data set available and the foundation is laid for the industry leadership, policymakers and the regulator to guide the required EDI reform;

• Leading practices were identified and through the benchmarking conference communicated to the key stakeholders;

• The trend analysis developed assists in defining the realistic performance targets for the various entities.
National Perspective

• The “baton” is available and the “champion” must now be confirmed who can able take the “baton” and lead the EDI optimisation process.

• The EDI Restructuring journey deliverables can broadly be categorised into seven areas. These areas are:
  – Industry Modelling;
    • Governance
  – Operating Model;
    • Revenue
    • Business viability
    • Shareholding
    • Compensation
    • Valuation, etc.
  – Legislative, Policy and Governance;
  – Human Capital;
  – Stakeholder and Communication Management;
  – Restructuring and Operational Readiness;
  – Asset Management.
Electricity Industry Restructure is a global phenomenon
Operational Perspective

• The macro policy environment and approach has determined both the nature and pace of reform in the industry.

• The bigger entities, such as Eskom Distribution, the Metropolitan Municipalities and some secondary municipalities have actively participated in the restructuring process, and have managed to influence the process to align with outcomes that best meet their individual needs.

• The one hundred and fifty or so remaining license holders are all smaller municipalities
  – This group has been without a real voice in the restructuring process.
  – The rationale for restructuring was based on creating a balance and equality in the industry, in the best interests of the end user of electricity.
  – The entities that stood to benefit most from the restructuring were the ones without a voice in determining the outcome.
The Focus of the Restructuring initiatives has not favoured the smaller municipalities who have the biggest need.
Can business viability for the EDI be achieved without restructuring?

- At a theoretical level, one could argue that the implementation of effective and efficient management practice would result in a profit making scenario for virtually all license holders.
- The reality is that for many of the small entities, the implementation of resources, systems, processes and infrastructure required to create long term sustainability are simply not achievable, particularly since most of these entities operate in a less than supportive and enabling governance environment.
- Despite acknowledging the tremendous effort made by individuals in the industry to keep the lights on, adopting a holding pattern will result in industry deterioration.
- Smaller entities are at bigger risk. The loss of one or two key resources can result in the collapse of service provision.
- In the bigger entities, it is perhaps easier to paper over the cracks, but the fundamental challenges remain. The bigger the operation, the longer and more challenging the process to recover from a catastrophic event.
In the interim, it appears to have been business as usual and service delivery remains a challenge.
Not all License Holders have adopted a business as usual approach

- A number of municipalities are leveraging the ringfencing work and benchmarking which was conducted to improve their business efficiency.
- Eskom has embarked on a national programme to restructure the total Eskom Holdings business, with significant changes being proposed for the Distribution business sector.
- The need to position Eskom to support the municipal environment in the national and security of supply interest is recognized and acknowledged within Eskom, and strategies are being developed to support this aspect of the Distribution mandate.
- It is apparent that Eskom is not sitting back and adopting a wait and see approach and is proactively repositioning its Distribution business to address operational needs and an anticipated broader role into the future.
What have the remainder of the License Holders been doing to improve their business?

- The question needs to be asked of the other 175 distributors. What are they doing about their business? Are the business operations effective and efficient? Are the appropriate business strategies in place? Is consideration being given to the future of the broader industry?
- Some distributors are addressing these matters;
- The majority of distributors are not strategically positioned to meet the challenges of the future;
- There is a real risk that the industry reform will now take place by default and without proper integration and optimisation.
Current Status

• There are >60 ringfenced entities today which presents an excellent foundation to turn around the distribution industry;
• Despite significant progress towards restructuring readiness of the EDI, limited operational changes were introduced;
• The number of distributors reduced;
• The industry challenges did not disappear;
• The South African electricity distribution industry remains highly fragmented;
• The key focus areas are still:
  – Recruitment, training and retention of resources
  – Asset management
  – Funding
  – Technical and non-technical losses
  – Revenue management
  – Service delivery
Lessons Learned (...1)

• The governance arrangements which were established to facilitate the RED establishment readiness activities, in general, worked well;
• The level of seniority and commitment to the restructuring process of the nominated people, who participated in the governance structures, had a direct impact on the success of the relevant institution;
• The level of commitment of the participants at the Sponsors Committee level filtered through the total governance structure and even impacted on activities at the work group level;
• Ambivalent commitment of some of the participants at some of the Sponsors Committees filtered through the total governance structure and even impacted on activities and progress at the work group level;
• Personal agendas at times generated unnecessary work and restricted the readiness progress;
• The absence of the relevant required enabling legislation is fundamentally the root cause for the delay in the RED establishment and the ultimate termination of the process.
Lessons Learned (...2)

- From a policy perspective the required initiative to create the necessary policy environment which could entrench the RED establishment was not evident;
- The regulatory competency was not leveraged from a policy perspective to assist with the EDI reform;
- The over reliance on a legislative solution to assist in the creation of the REDs, was a strategy which did not yield any results and ultimately failed the process;
- Overall visible sponsorship of the EDI restructuring programme and clear accountability for the success of the EDI restructuring lacked;
- Restructuring cannot take place without the willing asset contribution of the current asset owners;
- The restructuring of the EDI is a complex process.
Future

• The Cabinet decision to close EDI Holdings included a number of other actions and processes:
  – DoE will take over the programme previously undertaken by EDI Holdings.
  – The Department will review the whole electricity value chain with a view to developing a holistic approach to revitalise electricity infrastructure, energy security as well as the financial implications.
International Best Practice

Research indicates that to be recognised as having a world class Energy Industry, there needs to be separate financial and physical Energy flows, thereby, suggesting a Wires/Retail split.
Conclusion

- The current asset owners must maintain the reform momentum;
- Develop and implement the concession concept as an interim industry consolidation strategy;
- Focus on the EDI stabilisation in particular in respect of service delivery and revenue management;
- Develop and implement an integrated and holistic electricity supply industry reform programme;
- NERSA to ensure that the ringfenced status be maintained;
- Enforce, through NERSA, much tighter regulation of the EDI;
- Secure the required funding and resources and implement ADAM as a national asset management turn around solution;
- Develop and introduce an appropriate EDI skills programme;
- Establish the required programme management capability within DoE to effectively manage the portfolio of projects associated with the energy sector;
- Implement a tariff harmonisation process and leverage the work done in this regard by EDI Holdings;
- Establish benchmarking as a best practice in the electricity distribution industry;
- Use the benchmarking results to inform policy, to direct investment decisions, to guide the tariff regime and to enhance compliance.
THANK YOU