

Electricity Governance Initiative – South Africa

Two conflicting policies for renewable energy in South Africa raise questions about planning and governance for the renewable energy market

SALIEM FAKIR,
Head of Living Planet Unit, WWF-South Africa



WORLD RESOURCES INSTITUTE

प्रयत्न

PRAYAS ENERGY GROUP



Electricity Governance Initiative

The Electricity Governance Initiative (EGI) is a collaborative global initiative of civil society, policymakers, regulators, and other electricity sector actors to promote the open, transparent, and accountable decision-making processes that are a necessary part of a socially and environmentally sustainable energy future. The EGI is led jointly by the World Resources Institute and Prayas Energy Group (India). The National Institute of Public Finance and Policy (India) was centrally involved in development of the EGI Toolkit, a set of detailed assessment indicators, and implementation of the pilot phase of assessments in a number of South and South-East Asian countries. EGI is a partnership for sustainable development registered with the UN Commission on Sustainable Development.

Policymakers, regulators and citizens all over the world are grappling with the challenges of providing access to clean, reliable and affordable electricity, and addressing major environmental challenges including climate change. Improved transparency and public participation in the development of policy and regulation can help manage trade-offs between environmental, social, and financial considerations, and also identify points of convergence of these public interests. Building on global experiences, EGI has initiated a new effort to improve governance of electricity in South Africa (EGI-SA) by analysing government and regulatory capacity to create the right conditions for the promotion of social equity, energy efficiency and renewable energy, in line with the requirements of sustainable development and public interests.

During 2008-9, EGI-SA undertook a systematic assessment of decision-making processes in the electricity sector in South Africa. A research consortium was established, consisting of a partnership of civil society groups, including the Energy Research Centre at the University of Cape Town, Sustainable Energy Africa, Earthlife Africa, WWF-SA, the Green Connection, the International Labour Resource and Information Group (ILRIG), and independent researchers, and co-ordinated by Idasa's Economic Governance Programme. The assessment report is due to be published during October 2009.

Introduction

In January 2009, while the National Energy Regulator of South Africa (NERSA) was making its finishing touches to the Renewable Energy Feed-in Tariff (REFIT), the unexpected happened: the then Department of Minerals and Energy Affairs (these two functions have since been split with the creation of a separate Energy Ministry in May 2009 under the presidency of Jacob Zuma) introduced, through the Electricity Regulation Act (2006), a requirement for independent power projects (IPPs) to go through a tender process in order to obtain permits and licences to produce renewable energy.

There has been no better illustration of government policies and plans working at cross-purposes than this recent slip-up. This highlighted contradictory intentions and raised questions about the governance, future planning and stability of policy proposals for the renewables sector. Legally these government agencies perform complementary functions. Investors have to engage with both, and permission and support from both agencies is required for investor commitment in the sector. These agencies should not, therefore, be sending different messages.

One government agency says there is no need to tender but a feed-in tariff will apply, and the other says that if you want to generate renewable energy you must bid for it. This lends itself to investor uncertainty and confusion. There cannot be two processes with significantly different design features as they will produce different outcomes.

The processes also indicate a hidden tussle that stands to wreck the future of the electricity market in South Africa: whether the government should once and for all free-up the electricity sector or keep its hold over the market and allow the ongoing monopoly of the sector by Eskom.

This incident of a policy clash between two different approaches within government is symptomatic of how the renewable energy sector has gone through a number of fits and starts – each bringing the possibility of a new beginning, only to have policy confusion put a damper on a hopeful moment.

While the regulations and requirements for bids have not been removed, investors are still uncertain whether the REFIT will supersede the call for IPPs to go through a long-winded tender process. Verbal assurances from NERSA have been given that the REFIT will stand. However, IPP regulations will have to be amended and only apply to non-renewable suppliers as the current scope includes all power generation.

Playing a one-policy tune

Priority access systems, such as a feed-in tariff, are increasingly becoming a global norm. Renewable energy operators receive a preferential rate for what is termed a 'pay for energy delivered' contract, irrespective of when the electricity is generated.

Typically a contract may run from three to twenty years. A REFIT is better than a tender process because it cuts out arduous bureaucracy. Tenders require paperwork, calling for bids, establishing adjudication panels, determining prices and the potentially long-winded negotiations of power purchase agreements. More importantly they can favour big players and promote least-cost options, thus limiting the scope of renewables technologies that will supply renewable sources of electricity.

Feed-in tariffs have been proven the world over to be more efficient instruments than tender processes. The attempt in the UK to boost renewables through a tender process, under its Non-Fossil Fuel Obligation (NFFO) programme in 2002, produced paltry results. The UK experience indicates that bidders tend to underprice in order to secure a tender, and that when the actual project implementation begins they are unable to deliver the promised outputs because the costs are usually higher than originally estimated. This was one of the reasons why the UK could never match the successes experienced by Germany and Denmark.

The benefit of a REFIT is that it takes into account different cost structures for different technologies and builds these cost variances into the tariff structure. As soon as South Africa's REFIT was released and the tariff price determined for different renewable technologies, investors were able to do their financial modelling and self-determine whether it was feasible to go ahead with a project. This reduced the burden on government to spend time and resources on evaluating the feasibility of projects.

Good REFITs tend to pre-plan in their design targeted amounts of energy from specific types of renewable energy technologies and identify specific geographic locations where resources are abundant. Tenders are predisposed to be neutral on these issues as their premise is entirely focused on price rather than technology and geographical preference. REFITs can also be adjusted upward or downward based on cost trends as they emerge from price signals in the market.

South Africa's REFIT, while narrow in its scope of technologies, is a good start and saw significant public participation in the process leading up to its finalisation. This is in contrast to the proposed new IPP Bid Programme from the Department of Minerals and Energy (DME). The programme was quietly hatched and took the sector by surprise when it was released.

The introduction of a REFIT for grid-connected systems is regarded by various stakeholders interested in the development of renewable energy policy and markets as a hard-won victory. It spoke to fair prices for wind, small-hydro, concentrated solar power and landfill gas that make the financials look good. It guarantees a 20-year Power Purchase Agreement (PPA) compared to the earlier draft's recommendation of 15 years and a much lower tariff schedule. There are gaps, however: the scope of technologies could be expanded and the REFIT does not include off-grid projects.

While all of this receives applause, there are ongoing concerns about the guidelines' requirement that the single buyer office, also known as the Renewable Energy Purchasing Agency (REPA), meaning Eskom, must approve PPAs, which suggests that Eskom will have the final say. The guidelines go further in that they premise Eskom's approval based on a pre-planned quota, indicating that the projects that come in first will be given priority and that, once the quota is met, no further projects will be considered. This gives Eskom considerable power to decide which projects are selected and approved. There are also fears that larger companies may be able to lobby Eskom and ensure their projects are considered at the expense of smaller players.

This is the perception, despite the fact that the issuing of a licence by NERSA obligates REPA to purchase renewable energy subject to NERSA's conditions. The full workings of how the applications will be processed remains unclear. Potential investors and developers will have to test the system and find out how REPA makes decisions about projects and under what conditions Eskom will allow access to the grid. The fact that NERSA can approve a REFIT does not imply that access will be granted automatically; it all depends on how REPA views things, which is a worrisome aspect of the REFIT guidelines.

Market players are cautiously optimistic given the less than satisfactory experience of the dominance of a single utility in the past. There is, therefore, understandable fear that REPA could put a spanner in the works if it wanted to. Eskom's hand may be further strengthened in other ways. The DME, under the Electricity Regulation Act (2006), issued regulations appointing the systems operator, Eskom, as the national energy planner tasked with carrying out the National Integrated Resource Plan (NIRP). It is not entirely evident how this relates to the yet to be established South African National Energy Development Institute (Sanedi), which, under the National Energy Act (2008), has also been tasked with putting in place a national Integrated Energy Plan (IEP).

Who has control over the planning process can also influence the degree to which the renewable energy market can be opened, hence the fear that Eskom – if it develops the national plan – will once again dictate. Eskom has long complained that it worries about grid stability if there is no predetermination of the types and amount of power that comes from renewable energy sources if they are not carefully managed. There are also cost implications for introducing intermittent power on to the grid, which will most likely be passed on to IPPs. This is another area of cost uncertainty as it will affect the financial feasibility of projects despite the REFIT.

Renewable energy market players believe that the market for renewable energy has significant room for expansion: the renewable energy target could be expanded up to 15% rather than the currently envisaged 4% penetration, which takes us to the crux of why who is tasked with the development of South Africa's future energy plan is such a politically sensitive issue.

Conclusions and recommendations

While developers seem pleased with South Africa's REFIT, the process will have to be tested. In the meantime a number of issues need to be addressed:

- Certainty in the market, and clarity about processes and how decisions will be made are key to ensuring the renewable energy market is stable for investment and creating an enabling environment to build a healthy share within South Africa's future energy mix. There is a need for government to streamline the process and ensure that the best approach to stimulating investment in renewables is given the opportunity to do so. The IPP regulations need to be amended to exclude renewable IPPs from having to participate in a tender process.
- An integrated plan with improved renewable energy targets should help to streamline legislation and ensure that there is only one process for the approval and licensing of renewable energy investments. The determination of a quota for renewables should be an open and transparent process, where the determination of how much power must be generated by renewables takes place on a scientific basis and considers resource availability. There should be only one plan. This plan needs to set out a clear and decisive trajectory for the renewable energy market.
- The single buyer model needs to be expanded to include the much mooted Regional Electricity Distributors (REDs), to decentralise decision making about power generation. There should also be a plan for the inclusion of other renewable-energy technologies not covered by the current REFIT as well as off-grid capacity. The possibility of creating an independent single buyer option needs to be considered.
- Finally, countries where renewables have succeeded did well when utilities were made to buy renewable power from IPPs on a mandatory basis. South Africa's REFIT will only succeed if this mandatory obligation is instituted and Eskom is obliged to increase its renewable energy mix.