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## **Legal Potential to implement a 20 year PPA at a Municipal Level**

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### **1. Background**

Studies have indicated that South Africa has a substantial renewable energy (RE) resource base, suggesting a significant potential role for RE in the country's power supply. Against this backdrop is the increasing reality of limited power generation capacity from conventional sources that is hampering the South African economy. A slowing of the economy has a direct bearing on municipal revenue through a reduction in rate payments and electricity charges, which in turn reduces municipal revenue. High electricity prices, coupled with slowed economic growth can have a negative impact on rate-payer capability, resulting in late or non-payment occurring, or increases in illegal connections. These resultant outcomes have an important bearing on present and future municipal planning.

Recently, many homes, commercial properties and even large industries are considering the installation of alternative forms of power generation, including connecting these sources to their utility's electrical network as a means to deal with constrained electrical supply. These alternative facilities are intended to reduce the amount of electricity purchased from the main utility, thereby providing energy security and stability.

On the policy front, the 'Regulations on New Generation Capacity' came into force in 2009, and were subsequently updated in 2011. With this regulation, RE came more strongly into focus in South Africa. These regulations contain the initial rules for the deployment of the largest renewable energy generation bidding process in Africa (3,725 MW), which is currently underway. The regulations target utility-scale renewable energy generation deployment.

However, it is not just large-scale RE that has gained more attention. The New Generation Capacity regulation has also brought into focus the issue of small-scale power generation, as well as the issue of embedded generation. On 22 September 2011, NERSA (the National Energy Regulator of South Africa) approved Standard Conditions for Small-Scale (less than 100 kW) Embedded Generation

within Municipal Boundaries. Subsequently, many South African municipalities have developed specific embedded generation requirements.

Eskom is in an advanced phase of developing the standard NRS 097 Grid Interconnection of Embedded Generation. Part 2: Small-scale embedded generation, Section 1: Utility interface of the NRS 097 Grid Interconnection of Embedded Generation was completed in 2010. It is within this context that municipalities, such as eThekweni Municipality, have a key role to play in the future of local power generation. This review focuses on the potential to access local power generated from renewable energy technologies, including solar PV.

## **2. Municipalities and Renewable Energy**

Municipalities have an important role to play from both an energy sustainability and energy security perspective. However, the different regulatory provisions need to be understood and explored in order to ascertain the financial viability and long-term sustainability of electricity derived from renewable energy resources, as provided through embedded generators and small-scale independent power producers (IPPs).

The eThekweni Municipality would therefore like to investigate the legal options for purchasing electricity from electricity providers, other than Eskom. eThekweni Municipality has sought previous legal counsel on this issue. The main finding of this legal review was that in order to achieve this outcome sustainably, eThekweni would need to enter into long-term (20-year) contracts to buy electricity. This can either be achieved by:

1. Extending the current short-term IPP contracts, or
2. eThekweni would need to provide licenses for embedded generation themselves.

Currently, neither of these two options is possible within the current legislative framework. Municipalities are not able to license embedded generators, as NERSA is currently the only body that is able to issue such licenses, and contracts are limited to a three year period, based on a 2011 council resolution.

According to the previous legal advice provided to eThekweni, a council resolution of 2011<sup>1</sup> authorized the Head of Electricity to enter into a 3-year Power Purchase Agreement (PPA) with local electricity producers other than Eskom. However, the restriction on contracts with these embedded generators is three years. The resolution is described as containing the following four requirements:

1. The price paid to the independent power producer does not exceed the cost of electricity as purchased from Eskom
2. The power produced is “cleaner than Eskom’s coal fired electricity”
3. The Independent Power Producer meets a set of technical requirements for the grid connection
4. The cost of the grid connection is covered by the Independent Power Producer

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<sup>1</sup> 13/09/2011 Supplementary Agenda, Item 12

Legal advice was also sought at the time as to whether buying electricity at the same price as that purchased from Eskom meant that all regulations were being followed and that procurement was not required. It is not clear if these findings have been released by the previous legal counsel.

This document aims to build on these points previously raised, highlighting the current legal framework in which embedded generation operates. The intention of this review is for the analysis provided to be used to secure further legal counsel on the point of extended contracts, licensing of generators and paying a premium for renewable energy. Specifically, two outcomes are sought by eThekweni Municipality: firstly, a mechanism that will allow 20-year power purchase agreements with IPPs, or alternatively, the municipality licensing embedded generators themselves.

### **3. Purpose of the Review – Legal Options**

In order to allow for bulk 20-year PPAs within eThekweni Municipality, three legal options need to be investigated:

1. Long-term contracts according to Section 33 of the Municipal Finance Management Act
2. A by-law amendment/addition permitting the municipality to enter into 20-year PPAs
  - a. By-law amendment to extend or allow for longer power purchasing agreements
  - b. By-law addition to create a separate municipal entity, classified as an organ of state, to purchase electricity

#### *Option 1:*

The drawback of option 1 above is that Section 33 of the Municipal Finance Management Act (MFMA) requires public participation, council approval and endorsement by the National Treasury for each and every contract. The burden of these requirements would make the process far too onerous. However, Section 33 may potentially be avoided as the contracts do not have “future budgetary implications for the municipality” which mandates this process. The contracts with the IPPs would be at the same price charged by Eskom, and would therefore have no financial implications for the municipality going forward.

Furthermore, the positive additionality of overcoming the Section 33 requirements are in the interests of the wider community, as this approach will benefit the local economy by stimulating small-scale power producers in the whole region. The possibilities of this option succeeding will be explored in this policy review, in light of the current legislative framework.

#### *Option 2:*

The second option is to adjust a current by-law, or develop a new by-law, which would permit the municipality to enter into 20-year PPAs. Once again, as with the option above, the by-law would have to ensure that there will be no extra cost to the municipality. By-laws could also be used as the legislative platform to create a separate municipal entity, classified as an organ of state, which would purchase electricity from embedded generators. However, the biggest challenge to this option is

whether it meets the supply chain management requirements of the MFMA. These requirements will also be explored in this review.

*Option 3:*

Thirdly, the municipality could look into licensing embedded generators themselves. The likelihood of this option succeeding within the current policy landscape will also be analysed in the section below.

## **4. The Current Legal Framework Relating to Renewable Energy**

In considering the above legal options for extending IPP contracts and licensing embedded generators, certain key legislation and policy relating to local government powers and functions has been reviewed. These policies were specifically chosen in order to understand the current RE legal framework and how embedded generation might operate within this structure. The most relevant pieces of legislation reviewed include: the Constitution of the Republic of South Africa, Act 108 of 1996; the Municipal Structures Act, 117 of 1998; the Municipal Systems Act, 32 of 2000; the Municipal Finance Management Act, 56 of 2003 and the Electricity Regulation Act, 4 of 2006.

In order to analyse the second option of whether a potential by-law would correspond with the procurement regulations of the MFMA, the Public Finance Management Act, 1 of 1999, as amended by Act 29 of 1999 (PFMA), as well as the Preferential Procurement Policy Framework Act, 5 of 2000 (PPPFA), have also been examined.

The PFMA was promulgated to regulate financial management in both the national and provincial spheres of government. The MFMA needs to be read in accordance with this Act as it extends the same overarching principles to municipalities.

The PPPFA and its accompanying regulations need to be read in conjunction with the above when analysing supply chain management, as this legislation has been promulgated to prescribe a framework for a preferential procurement system.

### **4.1 The Municipal Finance Management Act (MFMA) and other RE Policy**

The most important piece of legislation in analysing the potential for an extension of the three year contracts, or alternatively, creating a by-law for this purpose, is the MFMA. The MFMA's key purpose is the sound and secure fiscal management of municipalities and municipal entities.

The Act has seven key purpose areas, central to this enquiry are two of these: 'budgetary and financial planning processes and co-ordination' and secondly, 'supply chain management'. The first is relevant to the investigation into extending the current three year contracts, while the second has bearing on whether the by-law would be in accordance with the MFMA regulations. These enquires are in line with Section 151 of the Constitution of South Africa which entrenches the core right of every municipality, within reason, to govern its own affairs.

The MFMA is the key Act when embarking on any query of municipal relations as it relates to municipalities, municipal entities and all other organs of state in their dealings with municipalities. It is for this reason that no contract can be entered into or extended without full compliance with the MFMA.

#### **4.1.1 Long-term contracts according to Section 33 of MFMA**

The first section of the MFMA to consider is the issue of annual budgets. This section relates to the extension of the three year contracts as the annual budget may not be affected by any extension or change.

According to Section 16 (1) of the MFMA (2003: 18):

“The council of a municipality must for each financial year approve an annual budget.”

However, Subsection (1):

“does not preclude the appropriation of money for capital expenditure for a period not exceeding three financial years, provided a separate appropriation is made for each of those financial years.” (MFMA, 2003: 18)

While capital expenditure is not clearly defined in the Act, the purchase of electricity would typically be classified as an operational expenditure and not a capital expenditure. In such a case, it would seem that this clause does not apply to a long term power purchase agreement.

In the case that electricity purchase is considered to be a capital expenditure, this clause suggests that a maximum contract period of three years applies. However, even if this could be extended, it is at best cumbersome. Section 17: Contents of Annual Budgets and Supporting Documents, requires that any changes to the budget are detailed and the supporting documentation supplied. This process would be far too onerous for every IPP contract on an on-going annual basis and would defeat the purposes for which the legislation was designed, which is ultimately to improve the fiscal and financial affairs of the municipality.

The issue of annual renewal is potentially avoided under Section 33 of the MFMA which discusses contracts having ‘future budgetary implications’. A municipality may enter into a contract which will impose financial obligations on the municipality beyond a financial year. However, if it is going to have financial implications beyond three years, this may only happen if the municipal manager, in accordance with section 21A of the Municipal Systems Act, has secured public participation, council approval and endorsement by the National Treasury. Assuming no financial implication beyond 3 years means that tariffs would be tied to Eskom rates, it is unlikely that such an arrangement would attract RE IPP investments even with 20-year contracts. A few technologies could potentially benefit in this regard should sufficient resource exist within eThekweni, but certainly not PV which is the subject of this review.

This section may suggest that the onerous requirements would only apply where financial obligations are imposed and that, where these obligations are lacking, a contract for longer than

three years may be entered into. However, it is not clear if this would be in contradiction of the three year IPP contract regulation imposed by the council resolution of 2011.

It is for this reason that the phrase 'impose financial obligations' requires closer legal scrutiny by legal counsel as these contracts could potentially be regarded as not imposing a financial burden if the rates at which electricity is bought remains constant in line with Eskom's rates. It is assumed that this does not 'impose an obligation' in the sense that an 'obligation' denotes an increasing duty or commitment. However, it is unlikely that such contracts would be seen as falling outside the scope of classification as a financial obligation.

Where a contract is interpreted as imposing a financial obligation, Section (3)(b) details how the requirements of Section (3)(a)(i) do not apply to contracts in respect of which the financial obligation on the municipality is below a prescribed value. This could also be used in a broader reading of 'impose financial obligations' to suggest that the clause may not be applicable as the full cost of the contract may not apply if the rate of the purchase remains constant. This would need to be explored by legal counsel. It is suggested that where there is no new obligation, such as a change in rate, that a contract may continue but the legalities of this would need to be explored.

There are two options that are used in financial models for embedded generators. The price can either remain constant over the entire period of the contract or can be indexed to CPI/ inflation. The difference will affect both the embedded generators and municipality as this will affect the payback period and the cost of energy. With no escalation, this will result in a very high energy price from year 1, particularly in a country with 6% inflation and a 20-year contract. It also exposes the project to inflation risks as the price would be calculated based on assumed inflation over 20 years.

However, if the purchasing of electricity is not classified as a capital expenditure in the MFMA (2003:27), but rather as a "category of goods as may be prescribed" as described under Section 33(2)(c)(i) then subsection (1) may not apply at all if the financial obligation is below a "prescribed value" or "prescribed percentage." Once again this could possibly allow for more manoeuvrability in extending PPA contracts.

The Electricity Regulation Act (ERA) can be read as supporting the above perspective in terms of extending the renewable energy PPAs from the perspective of energy security. The ERA (2004: 4) highlights this outcome in one of its key objectives, as set out in section 2, which states the object of the Act is to:

"(b) ensure that the interests and needs of present and future electricity customers and end users are safeguarded and met, having regard to the governance, efficiency, effectiveness and long-term sustainability of the electricity supply industry within the broader context of economic energy regulation in the Republic."

In terms of understanding how this applies to local municipalities, once again, this clause cannot be read in isolation but must be understood within the context of local government powers and functions. These are set out in Schedules 4B, 5B, Section 156 and 229 of the Constitution and further emphasised by Section 83 (1) of the Structures Act as well as Section 9 of the Systems Act.

Section 84 of the Structures Act details the Division of Functions and Powers between District and Local Municipalities. Municipal powers are in line with sections 156 and 229 of the Constitution, except for the powers vested in District Municipalities as detailed in subsection (1) of Section 84:

“(c) Bulk supply of electricity, which includes for the purposes of such supply, the transmission, distribution and, where applicable, the generation of electricity.”

Bulk supply in this sense is more extensive than the reticulation of electricity explanation set out in Schedules 4B and 5B of the Constitution. As set out in the Constitution, municipality’s rights are therefore to distribute electricity, with generation as a national competency. However, a broader reading of the ERA together with the Structures Act could be read as supporting electricity generation as within the functions and powers of the municipality, if applicable.

However, this situation is complicated further by Chapter Five of the MFMA which builds in a mechanism whereby National Treasury must monitor the pricing structure of organs of state that provide electricity, water or other bulk resources to municipalities, within the provision of municipal services. Before an organ of state submits a price increase it must give reasons and request National Treasury and the South African Local Government Association (SALGA) to give comments on the proposed amendment. National Treasury is also required to monitor payments made by municipalities or municipal entities for these bulk resources.

#### **4.1.2 By-law permitting the municipality to enter into 20-year PPAs**

The second aspect of the MFMA that requires careful consideration relates to the supply chain management aspects of the Act. The se need to be examined to ascertain if a by-law, which allows for 20-year PPAs, would comply with these sections.

The first option entails either the amendment of, or the development of a new municipal by-law, which would allow municipalities to enter into a 20-year PPA. The option to amend an existing by-law requires the investigation of existing by-laws relating to the purchase or provision of goods and services. The eThekweni Electricity Supply by-laws were analysed to see if there are any sections which could be amended to include municipal contractual obligations with embedded generators. The electricity supply by-laws do not contain any sections on the purchase of electricity by the municipality. These bylaws focus on the municipality as the sole supplier of electricity and the consumer as purchasing electricity. The by-laws cover aspects relating to new installations, connections to mains supply, inspections of new installations, metering requirements and maintenance of existing electricity infrastructure. The by-laws were not written with the concept of decentralized generation as a tenet but instead focus on a centralized system with the municipality as the supplier of electricity.

The electricity supply by laws could potentially be amended to include a section focusing on decentralized energy supply. This amendment could focus on facilitating the uptake of embedded generation. This will have the added advantage that the municipality could ensure the correct implementation of generators to maintain grid network integrity. The by-law could encompass both on and off grid generators. The quality of supply requirements, connection point technical

requirements, protection requirements, telemetry, and a tariff and extended contract periods for the PPA for with the embedded generators could be included in the by-law.

The contract period may be difficult to implement as it will be in contravention of the MFMA. However, the municipality could set a renewable energy tariff for embedded generators. Legal opinion needs to be sought in respect of whether NERSA approval for the renewable energy tariff is required. If the tariff is such that the payback period is drastically reduced for PV installations, then the contract period may not be of such significance anymore. With an improved tariff the debt tenor can be reduced significantly making it possible to get finance for small installations. Section 4 of the Municipal Systems Act could be used to support the inclusion of embedded generators in eThekweni Electricity by- laws. Section 4 allows the council of a municipality:

- the right to govern on its own initiative the local government affairs of the local community.
- finance the affairs of the municipality by—
  - i. charging fees for services; and
  - ii. imposing surcharges on fees, rates on property and, to the extent authorised by national legislation, other taxes, levies and duties.

The municipality may have to generate additional revenue for the increased tariff for embedded generators. The Municipal Systems Act makes provision for municipalities to “levy and recover fees, charges or tariffs in respect of any function or service of the municipality”. It could be argued that by providing embedded renewable energy through bulk purchase and consequently reduced prices, the municipality would be providing a renewable energy service to the public. The mechanism for implementing a tariff is outlined in Section 75A of Municipal Systems Act. The resolution will need to be signed by the City Treasury, the City Manager, The Head of Legal and Head of Procurement and Infrastructure. The resolution will be tabled with municipal council with a support from the majority of its members. It then needs to be made available public for a period of 30 days, but does not require public consent or participation.

Another way bylaws could potentially be of use is as the legislative platform to create a separate municipal entity, classified as an organ of state, to purchase power from IPPs. For both these options, supply chain management processes must be analysed.

Procurement of energy must be done in terms of the ERA and the New Generation Capacity regulations. Currently, long-term procurement has to comply with the New Generation regulations governed by the Department of Energy. However, shorter term procurement can happen subject to NERSA and PFMA or MFMA approval. In order for a municipality to purchase power, this is subject to MFMA processes and NERSA approval of the tariff. While NERSA currently holds the only right to license embedded generators, this could be challenged on the basis of the advantages of embedded generation in increasing energy security and supply, specifically by evoking the Constitution and the ERA for the right to universal access of electricity .

The current policy context for RE and municipalities purchasing power over a long-term period is not clear. Thus far Eskom has been designated as the central buyer of power from IPPs within the REIPPPP. Municipalities can however enter into PPAs and a few municipalities currently have this in place, including eThekweni. The restriction in the contract period is discussed above. The rates are

also not attractive for embedded generators. Municipalities are only able to purchase at Megaflex rates which is not economically viable for RE technologies.

Therefore, the role of municipalities regarding RE is not clearly defined. However, municipalities are excluded from the IPP definition as highlighted in the ERA on New Generation Capacity (2011), as well as the IRP2010. There is potentially a grey area in terms of NERSA's Standard Conditions for Small Scale (under 100kW) Embedded Generation within Municipal Boundaries. While the intention of this policy is more to monitor small-scale embedded generation, the policy mentions that the sheer number of installations could pose a potential problem for NERSA in terms of the applications it would receive for licences or registration. A further grey area is that currently there is no mandate allowing municipalities or Eskom to purchase excess electricity from small-scale embedded generators.

As part of the procurement process, Chapter 11 Part 1 of the MFMA requires municipalities to have a supply chain management policy. This policy must describe the supply chain management system that is to be implemented in the municipality. However, this aspect of the MFMA cannot be read in isolation, but must be read in conjunction with the Municipal Systems Act (MSA). The MSA sets out a definition for municipal services which can be understood as any service that a municipality, in terms of its powers and functions, provides for the benefit of the local community. This is regardless of whether:

- Such a service is provided, or to be provided, by the municipality through an internal mechanism contemplated in section 76, or by engaging an external mechanism contemplated in section 76; and
- Fees, charges or tariffs are levied for the service or not

The purchasing of power from embedded generators would therefore fall under this ambit.

A municipality must comply with the MFMA, the Supply Chain Management Regulations and the municipality's own supply chain management policy when:

- i. Procuring goods or services
- ii. Disposing of goods
- iii. Selecting contractors; and
- iv. Selecting "external mechanisms" for the provision of municipal services

However, there is potential scope to maneuver when reading Section 110(2) of the MFMA, which creates an exception around the application of Chapter 11, Part 1. This section relates specifically to Supply Chain Management (SCM) when a municipality or municipal entity contracts with another organ of state.

Section 110(2) provides that a municipality does not have to comply with the Supply Chain Management requirements where it contracts with an organ of state for:

- i. The provision of goods or services (such as the supply of bulk water to the municipality from a water board)

- ii. The provision of a municipal service (such as the provision of electricity to the community by Eskom); or
- iii. The procurement of goods and services under a contract secured by the organ of state, provided that the supplier has agreed to the procurement

Purchasing power from IPPs could be classified under the second point as a municipal service with an organ of state.

Section 239(b) of The Constitution (1996:75) supports this classification, defining an 'organ of state' as:

*“(a) any department of state or administration in the national, provincial or local sphere of government; or*

*(b) any other functionary or institution-*

*(i) exercising a power or performing a function in terms of the Constitution or a provincial constitution; or*

*(ii) exercising a public power or performing a public function in terms of any legislation”*

Section 78 of the Municipal Systems Act provides a process which municipalities must follow when they consider the delivery of a municipal service in the following instances:

- i. When an existing municipal service is to be significantly upgraded, extended or improved
- ii. When an existing service delivery agreement is going to end in the next year; and
- iii. When a new municipal service is to be provided

Read together, Section 110(2) of the MFMA and Section 78 of the Systems Act potentially allow for the possibility of the municipality, through a by-law amendment, or the addition of a new by-law, to create a municipal entity through which it can purchase electricity from IPPs. However, this entity would have to be an organ of state. The restriction on what the municipal entity can purchase and how purchasing would take place would need to be investigated. It seems likely that the municipal entity would need to be the RE power generator. The key legal question to be answered in this regard is: what flexibility could this municipal entity have that the municipal administration will not, and why will this flexibility be allowed?

When considering whether the Section 78 process is triggered, it is important to consider the circumstances of each case. Usually, whenever a municipality is planning to provide a service to the community, the Section 78 Systems Act process must be followed.

The Systems Act requires the municipality to decide if it will provide the municipal service itself or through an external service delivery mechanism. In terms of this, a municipal entity would be classified as an external service delivery mechanism. However, under the above definition of 'organ of state' under the Constitution, this entity can be either internal or external and still qualify as an organ of state.

An extended reading of this could be the creation of an entity within the municipality which purchases renewable energy power produced by IPPs. Where a broad definition is applied, then an external state entity could be established and would still be classified as an organ of state under Section 239(b)(b) which would allow Section 110(2) to apply. Both these options would thus exempt the municipality from complying with the SCM requirements where it contracts with an organ of state for the provision of municipal services, in this instance, the provision of electricity. The municipal service would be the purchasing of power from IPPs through an RE provider that would have to be an organ of state. The issue of whether it is possible to establish a public entity that is a separate organ of state and has different SCM needs to be answered by legal counsel.

The above is also in accordance with Section 85 of the Systems Act (2000:52) which deals with the Establishment of Internal Municipal Service Districts:

“(1) A municipality may, in accordance with the policy framework referred to in section 86, establish a part of the municipality as an internal municipal service district to facilitate the provision of a municipal service in that part of the municipality.”

If a municipality decides to explore the possibility of providing the municipal service through an external mechanism, it must give notice to the local community of its intention to explore this external option and assess its different service delivery options. Only after having undergone the full process required, can the municipality then decide on an appropriate internal or external mechanism to deliver the municipal service.

In summary, the Systems Act, as read with the MFMA, exempts a municipality from having to embark on competitive bidding processes should it select an organ of state to provide a municipal service. However, this argument fails if the municipal service is provided by a private company (IPP).

Regardless, the RE project would still need a generation licence if larger than 100kW, which would mean that the project would have to fall within the IRP process, unless a Ministerial exemption is sought for the project. The municipal entity referred to in the text would most likely need to be the RE project developer, in order to circumvent the MFMA.

Section 83 of the Systems Act provides for competitive bidding processes but creates an exception when a municipality opts to have a municipal service provided by a municipality, municipal entity or organ of state. The likelihood of this argument actually succeeding requires closer legal scrutiny.

### **4.1.3 Municipal Licenses for Embedded Generation**

The aim of the SCM legislation under the Preferential Procurement Policy Framework Act (PPPFA) is to ensure the service provider who will provide the best service at the best value for money is selected. This is usually for non-state actors, however, where the municipality would like to either purchase the power through a separate entity, or provide licenses for embedded generators itself, it must first assess its different service delivery options and conduct a feasibility study, prior to deciding on the appropriate means to deliver the municipal service. In terms of providing generation licenses, this would need to be read in conjunction with the ERA.

The ERA's key actions include:

- Establishment of the national regulatory framework for the electricity supply industry
- Outlines the procedures and requirements for a license application
- Development of National Energy Regulator of South Africa as the custodian and enforcer of the national electricity regulatory framework
- Repeal, amendment and substitution of laws including the Electricity Act (Act No. 41 of 1987) as addressed in Schedule I of the Act

The ERA considers the category of municipalities under the Municipal Structures Act that have the right to provide an electricity reticulation service within their area of jurisdiction. These municipalities must, amongst other duties:

- Comply with all technical and operational requirements for electricity networks determined by the Regulator;
- Integrate their reticulation services with the municipal integrated development plan;
- Progressively ensure access to at least basic reticulation services through appropriate investments in their electricity infrastructure;
- Provide basic reticulation services free of charge or at a minimum cost to certain classes of end users within its available resources;
- Ensure sustainable reticulation services through effective and efficient management and adherence to national norms and standards;
- Execute their reticulation function in accordance with relevant national energy policies.

A service delivery agreement entered into by a municipality with an external service provider regarding a reticulation service must also comply with the conditions of the Act.

This does not suggest that the municipality in any way has the jurisdiction to issue licenses under any circumstances. Currently the municipality only has authority to register embedded generators less than 100 kW Standard Conditions for Small-Scale Embedded Generation within Municipal Boundaries.

Sections 34(1) and 35(1) of the ERA make provision for the Minister of Energy, in consultation with the Regulator, to specify if and how new generation capacity is required. However, under Section 34 (1), there is no reference to municipal involvement in RE and under Section 35(1), only partial reference to municipal involvement in regulation processes. Potentially, broadly read, Section 35 (1) could provide some scope for municipal involvement in regulation, such as licensing processes, if this necessity could possibly be shown to meet the Constitutional requirements of fairness, equity and transparency.

This approach could be supported by the Systems Act with respect to the exercise of municipal powers and functions. Section 8 states that a municipality has the right to do anything reasonably necessary for, or incidental to the effective performance of, its functions and the exercise of its powers. In light of the limited electrical capacity argument and the rights discussed in the

Constitution, the municipality could argue that it is both fair and necessary that it is able to provide licenses. However, the likelihood of this approach succeeding is not high.

## **5. Conclusion**

Challenges currently exist in the implementation of long-term PPAs between municipalities and embedded generators, or small-scale IPPs. These challenges range from the economic viability of the various projects to different policy and legal complexities. The legal and regulatory framework forms the foundation for building a sustainable embedded generator infrastructure, specifically for solar and RE technologies. Effective and streamlined rules and regulations on a municipal level may help reduce installation costs and can significantly improve the market environment for solar energy technologies.

The relevant legislation pertaining to the procurement by municipalities of electricity generated from renewable energy technologies has been outlined in this review. The legal challenges that the municipality currently faces, within the current framework, have been examined. These include contract periods stipulated by the MFMA and existing tariffs as regulated by NERSA approval processes. These contract periods result in financing barriers for developers and the existing tariff charges poses challenges to the economic viability of RE embedded generator development, especially in the context of facilitating the implementation of solar PV in the eThekweni Municipality.

In order for municipalities to purchase electricity from providers other than Eskom, two options were explored:

1. Extending the current short-term IPP contracts, or
2. eThekweni providing licenses for embedded generation themselves.

In order to achieve these outcomes, three possible legal avenues were analysed. The first of these was long-term contracts according to Section 33 of the Municipal Finance Management Act. This option concluded that longer term contracts may be possible where the rate of purchase remains constant and thus does not impose a financial obligation on the municipality.

The second option explored is the possibility of a by-law amendment/addition permitting the municipality to enter into 20-year PPAs. The biggest challenge to this option is whether it meets the supply chain management requirements of the MFMA.

The final option explored was the potential for the municipality to license embedded generators themselves. The likelihood of this option succeeding within the current policy landscape does not appear to be likely.

The above options are put forward as potential legal avenues which need to be explored in more detail by legal experts. Legal counsel would be best placed to comment on the key issue of how the municipality can enter into long-term contracts and the tariffs to make this alternative energy option a sustainable reality. Ultimately, legal counsel would need to verify if the options suggested would fall within the Constitutional, MFMA and supply chain frameworks governing the municipality.

## **A. Legal Considerations**

In summary, there are three main areas of legislation that require further legal interpretation by an appointed legal counsel. The first area that requires attention is section 33 of the MFMA. There are three points that need further clarification under section 33. The first is the issue of whether many projects could be bundled into a single section 33 application as this would reduce the onerous nature of the process. The second point involves further guidance on whether the MFMA section 33 makes exemption for purchases with a 'low value' and how low this value has to be in relation to the project. This may be most applicable for very small generators. Legal opinion would be required on the definition of 'low value' in terms of section 33 MFMA by comparing it with other legislation. The third and final point of clarification involves legal opinion on what 'future budget implications' in terms of section 33 of the MFMA means and whether a contract at which the rate of purchase does not increase can be classified as therefore not imposing future budget implications.

The second area of legislation involves additions or amendments to municipal by-laws. The Electricity Supply By-laws could be amended to include embedded generators. The by-laws could regulate the tariff for EGs, the PPA contract periods and ensure quality of supply for network integrity. The tariff may need NERSA approval and this needs verification. The contract period may be in contravention of the PPA and clarification on this issue will also be required. The municipality could levy a tariff or surcharge for services provided. The levy or surcharge could then be utilised for bulk purchases of renewable energy.

The second way in which by-laws could provide assistance involves using them as a potential legislative platform to circumnavigate supply chain management requirements. This involves the issue of whether or not it is possible to get around competitive bidding through using an entity which is classified as an organ of state to purchase electricity for the municipality. Specifically, whether this entity would have greater flexibility than the municipal administration currently holds. Also, the restrictions around what type of entities municipalities can establish and own needs further exploration.

The third area requiring clarification is the point of the municipality issuing generation licenses. It seems that formal licensing by municipalities is very unlikely but considering that municipalities already 'license' installations under 100kW, this point is most applicable to larger installations. There is however an area that needs further verification regarding the requirements for a generation licence if the installation is under 100kW but is for commercial use. It is not clear whether the small scale generator requires a licence if it enters into a PPA with the municipality as this may be interpreted as commercial use. The correct interpretation of the SCSSEG is required in order to ensure that PPAs are lawfully entered into by parties concerned.

The most onerous part of the licence application procedures is not the administration but rather the process that needs to be followed in order for NERSA to grant, or refuse, the license. Legal opinion needs to be sought on the licensing by NERSA of PV installations over 100kW. The possibility of a 'right to a NERSA licence' if the municipality commits to buying the generated electricity also needs to be investigated. This point concerns the issues of central versus decentralised electricity generation. Legal opinion in this regard would also cover the issue of whether it is possible to buy renewable energy at a higher rate than Megaflex.

## 6. References

- 1] The Constitution of the Republic of South Africa, Act 108 of 1996
- 2] The Municipal Structures Act, 117 of 1998
- 3] The Public Finance Management Act, 1 of 1999
- 4] The Municipal Systems Act, 32 of 2000
- 5] The Preferential Procurement Policy Framework Act, 5 of 2000
- 6] The Municipal Finance Management Act, 56 of 2003
- 7] Electricity Regulation Act, 4 of 2006
- 8] Regulations in terms of section 76(4) (c) of the Public Finance management Act, 1999 (Act No. 1 of 1999 as amended by Act 29 of 1999) (PFMA): Framework for Supply Chain Management (23 December 2003)
- 9] Durban transitional metropolitan council, Electricity Supply By-laws, Municipal Notice No. 45 of 1998.