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Dear Mark

LEGAL OPINION REGARDING THE APPLICATION OF THE SCHEDULE 2 (5 OCTOBER 2021) TO THE ELECTRICITY REGULATION ACT IN RELATION TO THE MFMA AND THE NEW GENERATION REGULATIONS

1. INTRODUCTION AND BACKGROUND

1.1 We confirm that we have been requested to provide a legal opinion for our client, Sustainable Energy Africa ("**SEA**"), regarding Schedule 2 to the Electricity Regulation Act ("**ERA**").[1] Schedule 2 sets out the exemption from the requirements to obtain a license under the ERA and was amended on 5 October 2021 to include additional definitions and address licensing of resellers, among other things ("**Schedule 2**").[2]

1.2 Our understanding is that SEA is assisting with the South Africa-Germany Energy Programme ("**SAGEN**"), and as part of its mandate, is providing technical assistance in respect of embedded generation in municipal distribution areas, including embedded generation ("**EG**").

1.3 In light of the inter-relationship between the ERA, Schedule 2, the Electricity Regulations on New Generation Capacity ("**New Gen Regulations**")[3] and legislation governing the financial management of municipalities and municipal service delivery (respectively, the Local Government: Municipal Finance Management Act ("**MFMA**")[4] and the Local Government: Municipal Systems Act ("**MSA**"))[5], SEA has prepared a list of questions to be addressed in this legal opinion.

1.4 The questions are as follows:

1.4.1 **Question 1**: Can an embedded generator that is a net consumer (purchases more from the distributor than is exported onto the network) export power in

[1] Act 4 of 2006.
[2] GN 1000, Amendment of Government Notice Np. 737, Published on 12 August 2021, Government Gazette No 44989: Licensing Exemption and Registration Notice, *GG 45266*, 5 October 2021.
[3] GN R1366, *GG 40401*, 4 November 2016, as amended by GN 1093, *GG 43810*, 16 October 2020.
[4] Act 56 of 2003.
[5] Act 32 of 2000.

terms of Schedule 2? Can it receive some form of compensation for exports from the distributor, or does this contravene the MFMA (or MSA)?[6]

1.4.2 **Question 2**: Can an embedded generator that is a net generator (exports more back onto the network than it purchases from the distributor) export power in terms of Schedule 2? Can it receive some form of compensation for exports from the distributor, or does this contravene the MFMA (or MSA)?

1.4.3 **Question 3**: Consider the situation where a net generator exports power, and the kWh balance is towards exports but the Rand balance in the energy account is such that the distributor never owes money to the customer with the embedded generator. Does this contravene provisions in the MFMA?

1.4.4 **Question 4**: Can an embedded generator that is a 'pure' generator (exports all generated power back onto the network, and self-consumes no power that it generates) export power in terms of Schedule 2? Can it receive some form of compensation for exports from the distributor, or does this contravene the MFMA (or MSA)?

1.4.5 **Question 5**: Does the fact that NERSA has approved numerous export tariffs affect how the above cases are seen with respect to the MFMA?

1.4.6 **Question 6**: Do embedded generators that fall under Schedule 2 still need an ERA Section 34 determination to proceed? (New Generation Regulations are likely of relevance here). If so, will the embedded generator need a license because of requiring such a determination, or will it remain license exempt because of the provisions of Schedule 2?

1.4.7 **Question 7**: Are there any other provisions in the New Generation Regulations or ERA that are particularly relevant, or will restrict the implementation of embedded generation covered by Schedule 2 other than what is covered in the above questions?

1.5 We also note that we have had sight of a legal opinion provided to us by SEA, prepared for the City of Cape Town in August 2021 by Professor Geo Quinot of Stellenbosch University covering topics closely related to the above.

2. OVERVIEW OF REGULATION OF EMBEDDED GENERATION

2.1 To frame our responses to the above, it is necessary to briefly discuss the mechanisms for supplying electricity to the grid through an embedded generator. We have thus set out below the regulatory regimes related to (i) the ERA and Schedule 2, in respect of licensing and registration requirements; (ii) the MFMA in respect of compliance with public financial management and procurement / supply chain requirements; and (iii) the MSA in respect of mechanisms for service delivery.

[6] We have been provided with the "background" to Question 1 as follows: "*Interpretations of the 26 March 2020 update of the Schedule 2, and previous versions, were that net generators (exporting more kWh than was purchased from the distributor) were not covered by the exemption (because the customer was effectively selling power to the distributor – so supplying more than 'a single customer') , but that net consumers within the specified size ranges were exempt (they were considered to be temporarily 'banking' energy on the network rather than selling to the distributor). This was not necessarily legally well founded (there is no written opinion to this effect, nor was it ever confirmed by NERSA), but nevertheless it became the default interpretation used by municipal distributors around the country. To date it is written into the majority of municipal distributor policies on SSEG across the country. Distributors need to update policies to reflect the new Schedule 2 in a defensible manner*."

Electricity Regulation

2.2 The ERA generally regulates the electricity supply industry in South Africa. The following requirements related to licenses are relevant for addressing Questions 1 to 7 set out above:-

2.2.1 The ERA precludes any person from carrying out a number of activities without holding a license issued by the National Energy Regulator of South Africa ("**NERSA**") in terms of section 7 of the ERA unless otherwise exempt in terms of Schedule 2 to the ERA. This includes the operation of a generation facility and trading.[7]

2.2.2 Accordingly, certain activities as listed in Schedule 2 do not require a license to be issued by NERSA in terms of section 7 to the ERA.[8] Persons carrying out such activities are, therefore, able to do so without restrictions (subject to the additional requirements imposed as set out below).

2.2.3 The ERA then further stipulates that that certain activities which do not require a license are nevertheless required to register with NERSA if so determined by the Minister responsible for energy, currently the Minister of Mineral Resources and Energy (the "**Minister**"). This must be in accordance with a registration process published by NERSA.[9]

2.3 Schedule 2 currently provides both for activities which are exempt from holding a license and do not require registration (under paragraph 2), and those which are exempt from holding a license but do require registration with NERSA (under paragraph 3). These cover a range of activities, but the most relevant for owners of EG facilities are as follows:

2.3.1 the operation of generation facilities of any capacity which do not have a "Point of Connection" (i.e. are not interconnected to the national grid in any manner), with such facilities requiring neither a license nor registration;[10]

2.3.2 the operation of generation facilities with a Point of Connection, which is under 100 kW capacity, and where compliant with prescribed conditions for use of the Point of Connection issued by the distributor;[11]

2.3.3 the "*operation of a facility … with a capacity of no more than 100 MW with a Point of Connection on the transmission of distribution power system*" in one of the listed circumstances including where:[12]

(a) the facility supplies customers without wheeling (i.e. the "exported" power is not distributed or transmitted through the grid); or

(b) the facility supplies customers and uses wheeling, and a connection agreement is signed (e.g. with the municipality as distribution network operator),

(either 2.3.2 or 2.3.3 being a "**Grid Connected Facility**")

[7] Section 7 of the ERA.
[8] Section 7(2) of the ERA.
[9] Section 9(1) and 9(2) of the ERA.
[10] Paragraph 2.2 of Schedule 2.
[11] Paragraph 2.3 of Schedule 2.
[12] Paragraph 3.1 of Schedule 2.

2.3.4 In respect of the operation of a Grid Connected Facility with a capacity over 100 kW, although the operator of the facility is exempt from holding a license, registration with NERSA is still required.

2.3.5 It is noted for completeness that the 100MW threshold is with reference to the "Capacity" of the generation facility. "Capacity" is defined as the "output power (expressed in megawatts or MW)".

Municipal Financial Management

2.4 The MFMA does not directly regulate embedded generation but contains a number of obligations which municipalities are required to comply with in respect of the use of public funds. Accordingly, where any EG programme or similar scheme would result in payments by the municipality to the operator of the embedded generator, the following compliance requirements must be satisfied:-

Municipal budget

2.4.1 A municipality is only entitled to incur expenditure in terms of an approved budget.[13] The municipal council will typically approve an annual budget for each financial year.[14] Accordingly, the annual budget will need to set out the amounts allocated for expenditure on purchase of electricity by the municipality.

2.4.2 Note that whether municipalities are entitled to spend budgetary allocated for electricity purchases by making payments to embedded generators for exports will depend on how exactly the municipal budget is structured. If the budget explicitly provides for such payments (i.e. expenditure on EG purchases is a distinct item in the budget), or alternatively if the budget allows for electricity purchases without specifying the source, then it will be entitled to make payments for EG exports. Any such expenditure would be subject to any limits set out in the budget. By contrast, if the budget specifies that purchases are to be made from Eskom in particular (which may well be the case as the payments will be linked to the specific Eskom tariff paid by the municipality), then the municipality is not entitled to make those payments to an embedded generator instead.

Long-term financial commitments

2.4.3 The MFMA also places restrictions on municipalities incurring obligations with long term financial implications. Section 33 thus stipulates that if a contract will impose financial obligations on a municipality for longer than 3 years, the following procedure must be followed:-

(a) the municipal manager must carry out a public consultation process, which entails, 60 days prior to a meeting of the municipal council at which the contract is to be approved, publishing the contract, inviting comments from the local community;[15]

(b) the views of National Treasury and the relevant provincial treasury, and the national departments responsible for both local government and electricity must be solicited; and[16]

[13] Section 15 of the MFMA.
[14] Section 16 of the MFMA.
[15] Section 33(1)(a)(i) of the MFMA.
[16] Section 33(1)(a)(ii) of the MFMA.

(c) the municipal council must approve the contract through the adoption of a resolution, having taken into account the public comments received, the views of National Treasury and the relevant departments, and having considered the financial obligations of the municipality.[17]

2.4.4 These requirements will need to be met in order to enter into any agreement or arrangement with an embedded generator for a period exceeding three years. For shorter contractual periods of less than 3 years, section 33 is not triggered, although the embedded generator will not have the security of a guaranteed offtake agreement. Note that section 33(2)(c) does permit that the above requirements also do not apply to contracts for the supply of prescribed categories or goods or services, although at present purchasing of electricity is not prescribed in this way.[18]

2.5 Outside of financial expenditure controls, the MFMA also imposes obligations related to procurement. These are based upon the requirements in terms of the Constitution whereby any organ of state including municipalities are contracting for goods or services "must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective".[19] The relevant procurement requirements of the MFMA are addressed in Chapter 11 and are summarised as follows:-

2.5.1 The procurement requirements apply to any contract for goods or services. Although it is arguable whether the purchase of electricity is specifically a good or service, either way purchasing of electricity from an embedded generator will fall within the ambit of Chapter 11. [20]

2.5.2 Each municipality (and municipal entity) is required to have and implement a supply chain management policy which gives effect to the MFMA.[21]

2.5.3 Further detail is provided for in the Municipal Supply Chain Management Regulations to the MFMA ("**SCM Regulations**"). This sets out the thresholds for various forms of procurement which the supply chain management policy must provide for. This covers petty cash transactions (up to R2,000); written or verbal quotations (R2,000 to R10,000); formal price quotations (R10,000 to R200,000) and competitive bidding (above R200,000).[22]

2.5.4 Depending on the anticipated value of payments to be made to the embedded generator, the municipality will have to comply with one of the above procedures. If the municipality wishes to avoid formal written quotations or competitive tendering, it may have to explicitly limit the total amount payable to an embedded generator in any agreement or arrangement.

2.5.5 Alternatively, it is possible for the municipality to seek exemptions from the above procedures. This could be achieved in one of two ways:-

(a) The municipality's supply chain management policy can permit the accounting officer to dispense with official procurement processes in various circumstances, including in exceptional cases "*where it is impractical or impossible to follow the official procurement processes*", which may be justifiable in the embedded generator

[17] Section 33(1)(b) of the MFMA.
[18] Section 33(2)(c) also provides a similar exemption for contracts falling under a prescribed value or prescribed percentage of the municipal budget, but we are not aware of any such prescribed limit having been published.
[19] Section 217(1) of the Constitution.
[20] Section 110(1) of the MFMA.
[21] Section 111 of the MFMA.
[22] Regulation 12(1) of the SCM Regulations.

context given the impracticality of applying a full procurement process to every possible consumer who may wish to export electricity though EG and in circumstances where there is a set/ discernible tariff at which the municipality will purchase the electricity as the policy would satisfy the MFMA requirements of being "fair, equitable, competitive, cost-effective, transparent" should it provide certainty through means of a set / discernible tariff.[23]

(b) Alternatively, the MFMA itself permits the Minister of Finance, by notice in the Government Gazette, to exempt municipalities from compliance with provisions of the MFMA (which could include both Chapter 11 supply chain management requirements and section 33 long term financial commitment requirements). This can only be done "*where practicalities impede the strict application of a specific provision*" of the MFMA but could again it is likely justifiable in the EG context, provided support can be obtained from the Minister of Finance.[24]

2.5.6 It is also worth noting that the requirements of the Preferential Procurement Framework Act ("**PPPFA**") may be triggered in contracts for purchasing electricity if the municipality has to follow official procurement in terms of Chapter 11 of the MFMA. The PPPFA stipulates that a preference points system must be used by organs of state in their procurement policy,[25] and the Preferential Procurement Regulations, 2017 to the PPPFA, state that the threshold at which this applies is R30,000, at which point an 80/20 price / preference points scoring system must be used (or 90/10 above R50 million).[26]

Municipal Service Delivery

2.6 The MSA regulates the provision of municipal services by local government. Depending on the exact structure utilised, the adoption of a EG programme or similar could amount to a significant upgrade, extension or improvement of the municipality's electricity reticulation services which are a municipal service.[27] This means that the requirements under Chapter 8 Part 2 of the MSA may be triggered, whereby the municipality is required to carry out an evaluation of possible mechanisms for the provision of services (including internal mechanisms, service delivery agreements with other organs of state etc), and a public consultation process must be carried out.

2.7 The requirements for this process are as follows:-

2.7.1 The MSA sets out the various mechanisms that a municipality can employ to provide services. This includes:-

(a) internal mechanisms (departments, business units, and other administrative components within the municipality);[28] and

(b) external mechanisms (by concluding a service delivery agreement with other organs of state including municipal entities, and the public

[23] Regulation 36 of the SCM Regulations.
[24] Section 177(1)(b) of the MFMA.
[25] Section 2 of the PPPFA.
[26] Regulations 8 and 9.
[27] Section 155(6)(a) and (b) of the Constitution read with Schedule 4B make electricity reticulation a municipal competence and the purchase and sale of electricity accordingly falls within municipal services under the MSA.
[28] Section 76(a) of the MFMA.

sector as an "*institution, entity or person legally competent to operate a business activity*".[29]

2.7.2 In certain instances, a municipality is required to review the mechanisms through which it provides services. This includes where "*an existing municipal service is to be significantly upgraded, extended or improved*" and in our view this would include where the municipality intends to implement an EG programme, introduce a feed-in-tariff, etc.[30]

2.7.3 When such a review is required, the municipality must first carry out an evaluation of whether it can provide the service through an internal mechanism. This includes assessing costs and benefits, capacity, and impacts on job creation and consulting organised labour.[31] Once it has done so, the municipality is then entitled to explore an external mechanism. In doing so, it must consult the local community and organised labour.[32] Upon completing this process, it can then adopt an appropriate mechanism.[33]

2.8 We note that whether this MSA process will be triggered will have to be judged on a case-by-case basis for municipalities. This will ultimately depend on the extent of the change to the existing municipal service model in respect of electricity reticulation.

2.9 Factors that would point to a "significant" upgrade, extension or improvement include:-

2.9.1 the extent of technical upgrades that municipality would have to introduce such as bi-directional meters capable of keeping a running balance;

2.9.2 evaluation by the municipality of its grid capacity and the number of EG facilities that it could take on or whether the grid can support them;

2.9.3 the extent to which the municipality would have to revise, upgrade or amend its billing processes and systems and whether this would entail additional internal capacity or training, as the municipality may not be geared to make large numbers of payments to potentially hundreds / thousands of embedded generators;

2.9.4 whether this entails a change in service provider (i.e. Eskom) and impacts the bulk tariff level received from Eskom; and

2.9.5 the need to develop a standard grid connection agreement which can be rolled out at scale.

2.10 There are two key issues which arise in relation to this MSA service delivery evaluation. The first is that the process is onerous for municipalities, and requires wide consultation which can slow down or jeopardise undertaking a new mechanism such as an EG programme. The second is that the mechanisms of the MSA, including the requirement for external mechanisms to provide services through a service delivery agreement, are not a neat fit with a feed-in tariff approach for payments to embedded generators.

2.11 Unfortunately, the MSA itself does not provide for any explicit exemption or deviation for this process, nor is there a general exemption mechanism. Ultimately, in order to facilitate uptake of EG programmes by municipalities, it is likely that National Treasury / Minister of Finance (i.e. through guidelines under section 120 of the MSA) would have

[29] Section 76(b) of the MFMA.
[30] Section 77 of the MFMA.
[31] Section 78(1) of the MFMA
[32] Section 78(2) and (3) of the MFMA.
[33] Section 78(4) of the MFMA.

to issue a practice note or guideline whereby it clarifies that adopting payments for embedded generator exports would not be considered a significant upgrade, extension, or improvement to a municipality's electricity reticulation service delivery mechanism. Alternatively, the ideal scenario would be for the MSA to be amended as part of the broader structural reforms being undertaken by the Office of the Presidency under the umbrella of Operation Vulindlela.

3. QUESTION 1: NET CONSUMER

3.1 The first question addresses the position of a person with a generation facility that is connected to the municipal distribution grid and draws more power than they (potentially) export back onto the grid (i.e. is a "net consumer").

3.2 In such a scenario, assuming the generation facility has a capacity of no more than 100 MW, the generation facility would be a Grid Connected Facility. On a plain reading of the terms of Schedule 2, therefore, such a facility could be operated without a license issued by NERSA in terms of the ERA (although the activity would need to be registered if over 100 kW in capacity) and the person would be entitled to sell surplus electricity to the relevant municipality, provided all other regulatory requirements are met.

3.3 We note that SEA has highlighted the previously prevailing view of municipal distributors that, based upon the March 2020 update to Schedule 2 and previous versions of Schedule 2, that the operator of facilities who are net generators did not qualify for the Schedule 2 licensing exemptions, whereas net consumers did qualify (on the basis that a net generator was supplying more than a single customer).

3.4 This prevailing view is difficult to defend legally and does not accord with our understanding of the position under the March 2020 version of Schedule 2. However, given the amendments to Schedule 2 as of August 2021, it is unnecessary for us to express a view on the correctness thereof. To clarify the current position, the history of the relevant amendments to Schedule 2 must be noted:-

3.4.1 Prior to March 2020, Schedule 2 limited exempt grid connected small-scale EG to 1MW, and only where supply was to a "*single customer or related customers*".[34]

3.4.2 As of the March 2020 update to Schedule 2 of the ERA, the exempt grid connected small-scale EG facility cap was still maintained at 1MW, although it was now stated to apply where the operator of the facility "*supplies electricity to a customer or related customers*".[35]

3.4.3 Finally, in the August 2021 update to Schedule 2 of the ERA (and the current version), the grid connected EG cap was raised to 100MW, and applies where the facility is operated "*to supply electricity to one or more customers*".[36]

3.5 Whatever the previous interpretation, the updated reference to one "or more" customers in Schedule 2 makes it clear that a person operating a Grid Connected Facility is not restricted from supplying electricity to more than one customer. Further, "customer" is defined in Schedule 2 as "*a person who purchases electricity or services relating to the supply of electricity*" and in our view there is nothing in this definition that implies the supply could not be to a municipality pursuant to Schedule 2.[37]

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[34] Paragraph 2.2.1 of Schedule 2 per Government Notice No. 1231 in *Government Gazette 41237* of 10 November, 2017.
[35] Paragraph 3.1.1 of Schedule 2 per Government Notice No. 402 in *Government Gazette 43151* of 26 March 2020.
[36] Paragraph 3.1.2 of Schedule 2 (current).
[37] This is also supported by the inclusion of a separate definition for an "end-user" in Schedule 2 which, although the definition is not used elsewhere, strongly implies that a "customer" could include a municipality as it is distinct from an "end-user".

3.6 Accordingly, a net consumer is permitted to export power and rely on the exemption under Schedule 2 for a Grid Connected Facility provided that all of the regulatory requirements under Schedule 2 are met.

3.7 It is however necessary to consider the applicability of other regulatory requirements outside of Schedule 2, particularly under the MFMA and MSA.

3.8 In respect of a net consumer, it is understood that the municipality would apply an offset and the net consumer would get a credit on the electricity bill for the surplus energy exported onto the grid that is not consumed by the net consumer. A single bi-directional meter is installed to measure both the energy usage and the energy exported. In this scenario, there would be no compensation paid by the municipality for the exported energy. In this scenario:-

3.8.1 Under the MFMA, a net consumer does not impose financial obligations on a municipality, and accordingly provided that the municipality is not required to incur expenditure, its budgetary cycle approval is not impacted and the provisions of the MFMA are not triggered.

3.8.2 By contrast, under the MSA, even where no expenditure is incurred, the adoption of a new mechanism for service delivery (such as an EG programme) could trigger the requirements under Chapter 8 Part 2 of the MSA as detailed above at paragraph 2.6.

3.9 Accordingly, the regulatory requirements which would need to be satisfied would be the municipal financial management and municipal procurement and supply chain management requirements in the MFMA and related secondary legislation, as set out above at paragraphs 2.4 and 2.5.

3.10 In light of the above, it is our view that a net consumer operating a Grid Connected Facility would fall within the Schedule 2 exemption and would not be required to hold a NERSA license to generate electricity. The net consumer would also be entitled to sell electricity generated by the generation facility to municipalities, however, this is subject to regulatory compliance with the MFMA (if payments are made to the net consumer) and MSA in particular (regardless of whether payment is made to the net consumer).

4. QUESTION 2: NET GENERATOR

4.1 In light of our findings on Question 1 that the “single customer” requirement no longer forms part of Schedule 2, our view is that there is no distinction under Schedule 2 in respect of net consumers versus net generators (i.e. who export more power than they import). Accordingly, our view that the licensing exemption applies equally to net generators that meet the requirements under Schedule 2.

4.2 In respect of a net generator where compensation is intended to be made by the distributor for power exported onto the grid, the provisions of the MFMA are triggered as the payments to the net generator impose a financial obligation on municipalities and have budgetary and expenditure implications. Accordingly, the regulatory requirements which would need to be satisfied would be the municipal financial management and municipal procurement and supply chain management requirements in the MFMA and related secondary legislation, as set out above at paragraphs 2.4 and 2.5.

4.3 It must be noted that the ERA read with Schedule 2 is a separate regime and only addresses licensing / registration of generation facilities so do not alter, or purport to alter, other regulatory obligations placed on organs of state. Thus, the provisions of the ERA cannot override the MFMA compliance obligations of municipalities.

4.4 Our view, therefore, is that a net generator is entitled, under Schedule 2, to export electricity and is able to rely on the exemption contained therein provided that the requirements for such exemption are met. It is also entitled to sell such electricity to a municipality and receive compensation provided that the requirements of the MFMA and MSA as addressed above are met.

5. QUESTION 3: NET GENERATORS WITH NO PAYMENT

5.1 Our understanding of Question 3 is that despite being a net generator in terms of measured kWh, there is nevertheless no payment by the municipality in respect of the power exported onto the grid net generator.

5.2 This situation brings into question the concept of a "net consumer / generator". Although municipal documentation such as the City of Cape Town Guidelines for Embedded Generation[38] generally define net consumer / generator in terms of total kWh imported/purchased versus exported/sold, these concepts are not defined in national legislation, be it electricity regulation such as the ERA, or local government legislation such as the MFMA / MSA.

5.3 In our view, the distinction in respect of net kWh imported or exported is, itself, largely irrelevant for purposes of the ERA, MFMA and MSA. What does matter, in particular for the MFMA, is whether there is monetary spend by the municipality, for the reasons discussed under Question 1 and 2 above in relation to budgetary, expenditure and procurement considerations. Accordingly, where a "net generator" in terms of actual kWh nevertheless does not cause a net spend by the municipality to which it is exporting electricity, the provisions of the MFMA will not be triggered.

6. QUESTION 4: PURE GENERATOR

6.1 In a technical sense, the distinction between a pure generator and a net generator is that while the net generator both exports and imports power, the pure generator only exports power.

6.2 In a legal sense, we are of the view that there is no legal distinction between these two concepts as follows:

6.2.1 Under Schedule 2, the relevant exemption for a Grid Connected Facility depends on (i) the generation capacity of the facility (i.e. up to 100kW/ 100 MW); (ii) whether the generation facility is grid connected; (iii) whether or not wheeling occurs; and (iv) compliance with connection requirements. There is no consideration as to whether importing of power occurs.

6.2.2 Under the MFMA, as discussed under Question 3, the actual kWh imported or exported is irrelevant, but rather the expenditure by the municipality is what matters. The only difference between a net and pure generator is the amount of the expenditure, which is unlikely to impact MFMA compliance although may have relevance when it comes to procurement thresholds under supply chain management policies and the Municipal Supply Chain Management Regulations (which could also have implications in respect of preferential procurement).[39]

6.3 Accordingly, our views set out in Question 2 in respect of net generators are equally applicable to pure generators. However, we note that in practice, a pure generator is likely to have a much larger generation capacity (i.e.in the tens of MW or close to the 100MW limit). This will likely have an impact in respect of procurement, and will have

[38] Available at https://www.sustainable.org.za/uploads/files/file49.pdf access on 8 November 2021.
[39] Regulation 12(1) of the Municipal Supply Chain Management Regulations.

budgetary implications due to the payments to such generators. In such cases a significant net spend will be incurred (for substantial net generators or pure generators), and it is more difficult to consider that such power is "competitive and cost effective" without carrying out a normal procurement process. This holds true even in cases where the export tariff is less than the purchase price from Eskom, as a tender process could in theory deliver power cheaper than even the export tariff.

6.4 Further, a municipal distributor could apply for deviation from the standard tendering processes, but as set out in paragraph 2.5.5 such deviations require that it is either "*impractical or impossible to follow the official procurement processes*" or "*practicalities impede the strict application*" of MFMA requirements. Therefore, tt will be difficult to motivate that it is impractical/impossible to procure power from larger EG facilities through a competitive process, particularly since only a handful of such facilities will be necessary to address a typical municipality's energy needs. This question will require further exploration, including to consider whether a feed-in tariff could be applied for larger EG facilities. MFMA procurement processes are, therefore, appropriate in these circumstances pending further clarification.

7. QUESTION 5: IMPACT OF NERSA APPROVING EXPORT TARIFFS

7.1 NERSA is established in terms of the National Energy Regulator Act, which provides for its formation, membership and functions.[40] The ERA stipulates that NERSA is the "*custodian and enforcer of the regulatory framework provided for in this Act*".[41] In carrying out its tariff approval powers, it is exercising a function explicitly granted to it under the ERA to "*regulate prices and tariffs*".[42]

7.2 The core of the question being asked under Question 5 is whether, through the act of approving tariffs, NERSA can or does influence the application of the MFMA / MSA in respect of the sale/purchase of electricity from embedded generation facilities.

7.3 This question can be addressed by reference to the principle of legality, which requires that all exercises of public power be lawful.[43] A part of the principle is the concept that when an administrative body which is created and empowered by legislation carries out its functions, it must do so within the limits of the powers ascribed to it, and any action beyond its power is said to be "*ultra vires*" and is accordingly unlawful.[44]

7.4 The legislative powers granted to NERSA only relate to gas matters under the Gas Act, electricity under the Electricity Regulation Act, and other matters related to energy regulation. They do not extend to exercising any power under the MFMA or administering municipalities, which is instead administered by the Minister of Finance and National Treasury (itself established under the Public Finance Management Act).[45]

7.5 It is a cornerstone principle of our law that NERSA cannot, through exercising powers within its functional jurisdiction, bind other administrative bodies over which it does not exercise oversight, nor can it influence the interpretation / meaning of national legislation, which is a matter for Parliament and courts.

7.6 Accordingly, the setting of export tariffs by NERSA does not, in itself, influence our views as set out above in respect of the MFMA (or MSA) or the legal interpretation of this legislation.

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[40] Act 4 of 2004.
[41] Section 3 of the ERA.
[42] Section 4(a)(ii) of the ERA.
[43] The Law of South Africa, Volume 2(3) at 13.
[44] Ibid.
[45] Act 1 of 1999.

7.7 Where a set export tariff payable would influence the application of the MFMA is in respect of the justification for the accounting officer to dispense with official procurement processes in various circumstances, including in exceptional cases "where it is impractical or impossible to follow the official procurement processes", which may be justifiable in the embedded generator context given the impracticality of applying a full procurement process to every possible consumer who may wish to export electricity though EG and in circumstances where there is a set/ discernible tariff at which the municipality will purchase the electricity as the policy would satisfy the MFMA requirements of being "fair, equitable, competitive, cost-effective, transparent" should it provide certainty through means of a set / discernible tariff.

8. QUESTION 6: REQUIREMENT FOR SECTION 34(1) DETERMINATION

8.1 Question 6 addresses three somewhat separate issues:

8.1.1 Is a section 34(1) determination (whereby the Minister responsible for energy determines that new generation capacity should be procured by organs of state, including the power to stipulate which organs must / may purchase the power) required for a municipality to purchase power from Grid Connected Facility?

8.1.2 If so, does this impact whether a license is or isn't required?

8.1.3 How do the New Gen Regulations impact the above?

Is a section 34(1) determination required?

8.2 At the outset, we note that the specific issue of whether a municipality is entitled to procure new generation capacity in the absence of a section 34(1) determination under the ERA was brought before the High Court in the matter of *City of Cape Town v National Energy Regulator of South Africa*.[46]

8.3 In this case, NERSA contended that it was not able to issue licenses for generation capacity procured by municipalities since, at the time, the New Gen Regulations did not allow for municipal procurement of energy and that there was also no section 34(1) determination relating to the procurement of new generation capacity by municipalities (existing determinations referring only to Eskom SOC Ltd).

8.4 The High Court dismissed the matter in August 2020, determining that this was an inter-governmental dispute and that, since not all avenues for determining the dispute had been exhausted under the Intergovernmental Relations Framework Act,[47] the dispute was brought before the courts prematurely. Accordingly, the High Court did not rule on the merits of the section 34 issue and so the substantive questions posed by the City of Cape Town remain unanswered.

8.5 However, the fact that the New Gen Regulations and Schedule 2 of the ERA were amended may render the above matter of academic interest only. In *City of Cape Town*, the issue experienced by the City was ultimately that NERSA was not willing to issue licenses to potential generators in the absence of a section 34 determination. With the amendments to Schedule 2, this position has fundamentally changed in light of the following:-

8.5.1 In order to be issued a generation license, an application is required to satisfy a number of criteria in making an application to NERSA.[48] This includes

[46] [2020] ZAGPPHC 800.
[47] Act 13 of 2005.
[48] Section 10(1)(a) and (2) of the ERA.

"*evidence of compliance with any integrated resource plan applicable at that point in time or provide reasons for any deviation for the approval of the Minister*".[49]

8.5.2 The Minister issues section 34(1) determinations in accordance with, and to give effect to, the current integrated resources plan ("**IRP**") (currently the IRP 2019), and so NERSA has generally taken the issuance of determinations in terms of section 34 of the ERA as a prerequisite for "evidence of compliance" with the current IRP.

8.5.3 Thus, the issuing of licenses has been contingent on section 34 determinations being issued. This has previously been problematic for embedded generation above 1 MW as the generation for electricity from such facilities and subsequent trading required a license. Now that the MW cap has been lifted to 100 MW, and only registration is required, this impediment no longer arises for a Grid Connected Facility with a capacity of 100MW or less as was previously the case. The key issue experienced by the City of Cape Town thus falls away.

8.5.4 Of course, we note that registration is still required (unless a generation facility is under 100kW capacity) and is carried out in accordance with a procedure prescribed by NERSA. The most recent procedure for registration of embedded generation was published by NERSA in October 2020 ("**Registration Procedure**").[50] The Registration Procedure imposes certain requirements for registration such as technical capability and an executed power purchase agreement but does not mention IRP compliance or a determination being required.

8.5.5 We further note, however, that the Registration Procedure predates the 2021 amendments to Schedule 2, and thus NERSA could change the registration requirements for "larger" embedded generation over time. It is however unlikely that NERSA will prescribe compliance with section 34(1) of the ERA as a prerequisite to the registration of the activity.

<u>Does the need for a section 34(1) determination impact licensing exemptions?</u>

8.6 In light of the above, it is not necessary to address the second part of Question 6 (i.e. whether the need for a section 34(1) determination would cause a Grid Connected Facility to require a license). However, our view is that even if a section 34(1) determination was a prerequisite for a municipality to enter into an arrangement with a Grid Connected Facility, this does not influence the licensing situation under Schedule 2. The section 34 determinations deal with procurement of new generation capacity by organs of state, and do not dictate what activities carried out by persons in relation to the generation facility do or do not require licenses. Schedule 2 of the ERA stands alone and there is no mechanism in the ERA whereby a section 34(1) determination requirement would change explicit exemptions provided for in Schedule 2.

<u>Applicability of the New Gen Regulations</u>

8.7 Finally, we address the third part of Question 6 (the role of the New Gen Regulations). The issues which thus arise are whether (i) the New Gen Regulations are generally applicable to municipalities when utilising feed-in tariffs under a EG programme; and (ii)

[49] Section

[50] Registration Procedure in Terms of Schedule 2 of the Electricity Regulation Act, 2006 (ACT NO. 4 OF 2006), available at https://www.nersa.org.za/wp-content/uploads/2021/02/Registration-Procedure-.pdf accessed on 9 November 2021.

whether a municipality is entitled to procure power pursuant to a SSG programme outside of the New Gen Regulations:-

8.7.1 In respect of (i), it should be noted that the New Gen Regulations were updated in October 2020 to cater for municipalities, and they now apply to the procurement of "new generation capacity" by all organs of state, including municipalities.

8.7.2 The definition of new generation capacity, in turn specifically states that this refers to capacity to be procured "*pursuant to a determination in terms of section 34 (1) of the Act*". This seems to make it clear that the New Gen Regulations (including, importantly, the requirement to comply with municipal public-private partnership requirements) do not apply to an EG programme which is independent of any section 34(1) determination.

8.7.3 In respect of (ii), this again comes back to another principled issue discussed in *City of Cape Town*. The core of the matter is whether the intention of section 34(1) and the New Gen Regulations is to fully circumscribe the procurement of all electricity purchasing by organs of state.

8.7.4 In our view, section 34(1), on a plain reading of its wording, is a permissive section which grants the Minister the ability / power to adopt a programmatic approach to procurement of generation capacity. Section 34 of the ERA provides that the Minister *may,* in consultation with NERSA, determine that new generation capacity is needed and require that it must be procured through a tendering procedure. The New Generation Regulations establish rules and guidelines that are applicable to the undertaking of an IPP Bid Programme and the procurement of an IPP for new generation capacity as determined by the Minister under section 34 of the ERA.

8.7.5 Nothing in section 34 of the ERA, the ERA generally nor the New Gen Regulations contains a prohibition on organs of state purchasing electricity outside of this mechanism, and what has previously hampered municipalities from doing so in the context of a widespread EG programme, was the low cap on exempt embedded generation that prohibited generators from obtaining a generation licence.

8.8 The ultimate conclusion in respect of Question 6, therefore, is that a section 34(1) determination is not required in order for a municipality to purchase electricity directly from an EG facility which is exempt from licensing requirements. Further, the municipality is permitted to do so outside the framework of the New Generation Regulations.

9. QUESTION 7: ADDITIONAL REQUIREMENTS IN NEW GEN REGULATIONS

In light of our response in respect of Question 6, there are no further requirements of the New Gen Regulations to highlight.

10. CONCLUSION

We have set out in Annexe A attached hereto a summary of our findings.

Yours sincerely

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ANNEXE A

SUMMARY OF FINDINGS

	Question	**Summary**
1	Can an embedded generator that is a net consumer (purchases more from the distributor than is exported onto the network) export power in terms of Schedule 2? Can it receive some form of compensation for exports from the distributor, or does this contravene the MFMA (or MSA)?	A net consumer is entitled to export power and rely on the exemption under Schedule 2 provided that the power output of the generation facility is less than 100MW and the other regulatory requirements under Schedule 2 are met. Registration with NERSA is required for facilities over 100kW. Additional regulatory requirements include (i) MFMA compliance (only if payments are to be made to the net consumer; if offset is used such that no payments are made but only a credit, then MFMA compliance is not required); and (ii) MSA compliance, in particular in relation to assessments of service delivery mechanisms.
2	Can an embedded generator that is a net generator (exports more back onto the network than it purchases from the distributor) export power in terms of Schedule 2? Can it receive some form of compensation for exports from the distributor, or does this contravene the MFMA (or MSA)?	There is no distinction between net consumers and net generators from a licensing perspective. Thus, our answer to Question 1 is applicable here as well. MFMA and MSA compliance is again required.
3	Consider the situation where a net generator exports power, and the kWh balance is towards exports but the Rand balance in the energy account is such that the distributor never owes money to the customer with the embedded generator. Does this contravene provisions in the MFMA?	In such circumstances, the requirements for MFMA compliance are not triggered irrespective of net import or export.
4	Can an embedded generator that is a 'pure' generator (exports all generated power back onto the network, and self-consumes no power that it generates) export power in terms of Schedule 2? Can it receive some form of compensation for exports from the distributor, or does this contravene the MFMA (or MSA)?	From an MFMA / MSA compliance perspective, there is no legal distinction between a net generator and pure generator. The larger MW capacity of a pure generator may, however, impact whether a municipality can motivate for deviation from standard procurement processes.
5	Does the fact that NERSA has approved numerous export tariffs affect how the above cases are seen with respect to the MFMA?	The approval of tariffs by NERSA does not influence our above views or the correct legal interpretation of the impact of the ERA, Schedule 2, MFMF or MSA.

		It is however noted that to the extent that the municipal supply chain management policy permits the accounting officer to dispense with official procurement processes in various circumstances, including in exceptional cases "where it is impractical or impossible to follow the official procurement processes", it may be justifiable in the embedded generator context to dispense with official procurement under the MFMA given the impracticality of applying a full procurement process to every possible consumer who may wish to export electricity though SSEG and in circumstances where there is a set/ discernible tariff at which the municipality will purchase the electricity as the policy would satisfy the MFMA requirements of being "fair, equitable, competitive, cost-effective, transparent" should it provide certainty through means of a set / discernible tariff.
6	Do embedded generators that fall under Schedule 2 still need an ERA Section 34 determination to proceed? (New Generation Regulations are likely of relevance here). If so, will the embedded generator need a license because of requiring such a determination, or will it remain license exempt because of the provisions of Schedule 2?	A section 34(1) determination is not required for a municipality to purchase electricity from an embedded generator. Updated registration rules could, in principle, impose IRP compliance or similar requirements but do not currently do so. Even if the above is incorrect, the existence of section 34(1) determination does not impact the exemption from licensing requirements. The New Gen Regulations are not applicable to the procurement of electricity by municipalities, nor do they restrict municipalities from doing so outside of the New Gen Regulations framework.
7	Are there any other provisions in the New Generation Regulations or ERA that are particularly relevant, or will restrict the implementation of embedded generation covered by Schedule 2 other than what is covered in the above questions?	No further requirements to highlight.