Corporate & Commercial

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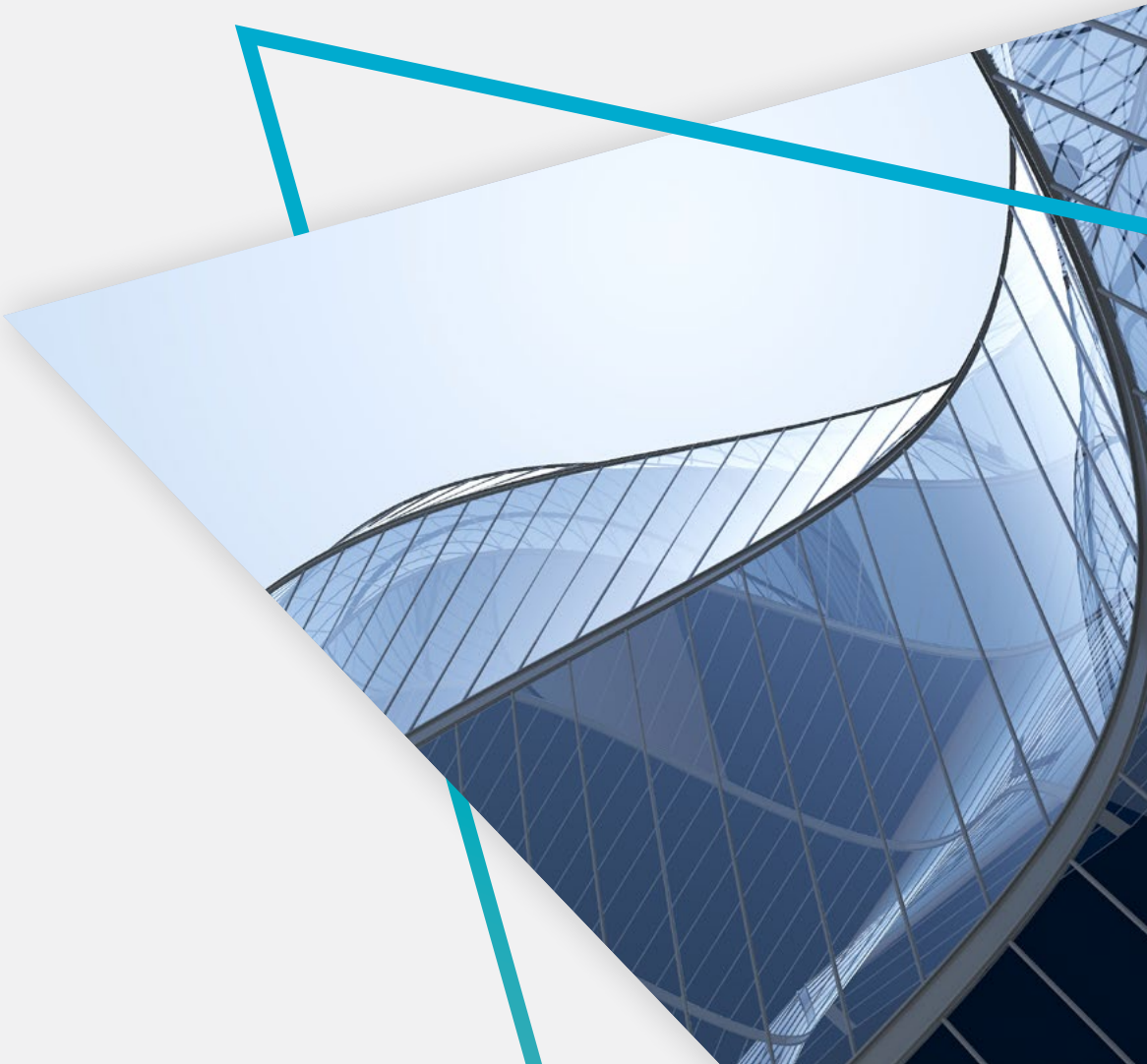

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SOUTH AFRICA

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The Promulgation of the Economic Regulation of Transport Act is a marked step towards rail reform and privatisation

On 11 June 2024, President Ramaphosa signed the Economic Regulation of Transport Act 6 of 2024 (Act) into law, marking a significant development in respect of economic regulation of transport and rail reform. However, the date of commencement of the Act is still to be determined.

The Act introduces major changes to the transport sector by establishing the Transport Economic Regulator (Regulator), a crucial step in rail reform following the gazetting of the draft Network Statement by Transnet SOC Limited (Transnet) on 19 March 2024, which we previously discussed on 2 May 2024 here.

It is intended that the Regulator will serve as a consolidated economic regulator for transport, in respect of road, rail, shipping, ports and aviation. Accordingly, the Act has amended the National Ports Act 12 of 2005, the Airports Company Act 44 of 1993, the Air Traffic and Navigation Services Company Act 45 of 1993, the National Land Transport Act 5 of 2009 and the South African National Roads Agency Limited and National Roads Act 7 of 1998. This streamlining of regulators, if implemented effectively, will help to make the transport system more efficient and cost-effective. As previously noted in our article available here, the ambit of the Act is vast and the implementation thereof will not be without its challenges.

The Minister of Transport may also extend the Act's ambit to other public entities, markets, facilities or services, including, significantly, private entities, under certain conditions. This provision is particularly relevant for sectors where private entities are sole providers of services and monopolies.

The key aspects of the Act are the empowerment of the Regulator to control prices across the transport sector and the introduction of provisions governing access to rail infrastructure (currently under the control of Transnet) by third parties, including private sector players.

Price regulation

The Regulator is envisaged to act similarly to the National Energy Regulator of South Africa (NERSA), and will approve price tariffs of regulated entities, such as Transnet, for use of the infrastructure in those sectors. This aims to prevent monopolistic pricing by regulated entities and inefficiencies, while also levelling the playing field. Importantly, the Regulator has the discretion to tailor the price controls in respect of each sector.

The process entails the submission of tariff proposals by regulated entities for approval. These proposals may be varied and approved of with or without conditions, or denied and be subject to a request for a new pricing proposal by the Regulator. In determining price controls, the Regulator must consider proposals on a case-by-case basis, with regard to the following factors:

- the regulated entity's operating efficiency and effectiveness;
- the need for investment and security of supply in the regulated market;

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- the opportunity cost of capital, including the average rate of return on other similar domestic or international services;
- the actual or forecast cost of debt;
- any reasonable cost differentials between the different types of facilities provided;
- the likely effect of the proposed price control on the economy, employment, consumers and small or medium enterprises; and
- any advantage or disadvantage an operator has due to state investments, transfers and legislation.

Notably, there is no mention of capacity as a rate determinant as historically applied by NERSA, which has resulted in hiked up tariffs.

Importantly, the Regulator is also mandated to consult with industry players and the public regarding the proposed price tariffs before approval.

Existing sector price regulations (and any new regulations published by the Regulator) will remain in force until the Regulator publishes a new price control. Unfortunately, there is no provision for internal review of the price controls, or a general time period for which the price controls will remain in force. However, the Regulator is still empowered to conduct an extraordinary review in terms of section 12 of the Act, and to direct a price control reduction, in terms of section 21, pursuant to an investigation following a complaint. Additionally, the Act establishes the Transport Economic Council, as the primary adjudicative entity, to which *"any person adversely affected"* by a decision by the Regulator may apply for review of a price control determination.

Access to infrastructure

One of the most impactful developments is that Chapter 2 of the Act provides for access to rail infrastructure, currently controlled by Transnet, by means of standard terms or bilateral agreements with *"access seekers"*. This paves the way for privatisation of the rail sector, as it will entitle, *inter alia*, private sector players to access Transnet's rail network, subject to an access agreement to be concluded with Transnet approved by the Regulator, and payment of an access fee. Minimum requirements must be met in terms of the access agreement before submission to the Regulator, and the conclusion of the access agreement is subject to a lengthy and detailed process, which may involve the Regulator seeking representations from all entities using the infrastructure. The Regulator will thereafter work with Transnet's Infrastructure Manager in overseeing access to the rail network, in allocating slots and capacity.

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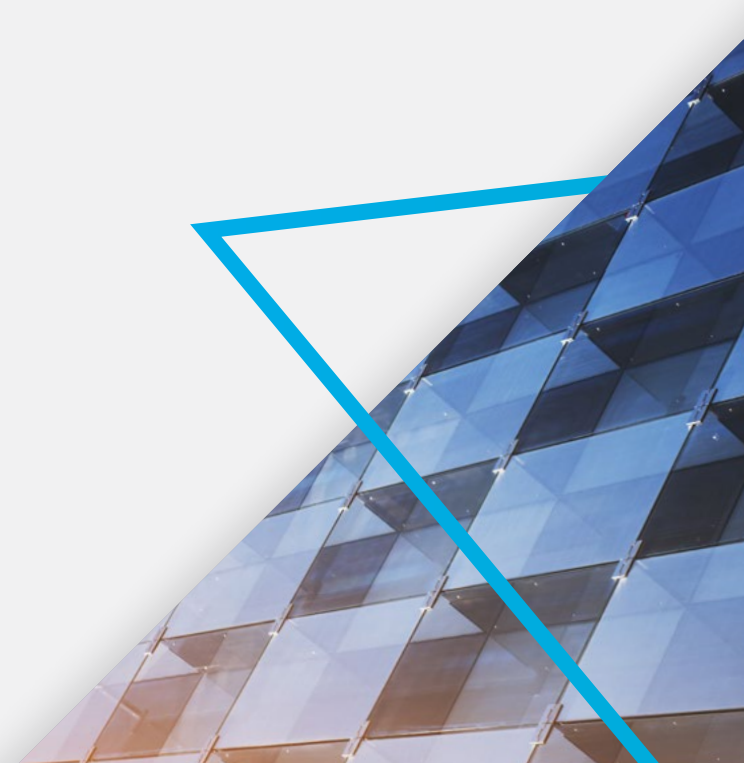
In terms of its draft Network Statement gazetted for public comment on 19 March 2024, Transnet proposed a minimum access fee of 19,79 cents/gross ton per kilometre to the rail network. This has drawn significant negative attention in the rail industry as it is based on gross rather than net weight, and may have the consequence of increasing transport costs across the supply chain. In turn, this may result in increased resort to road transport. However, the Regulator has ultimate power in terms of the Act to determine the minimum access fees and therefore, this minimum access fee is subject to approval by the Regulator and will hopefully be revised, taking into account industry and stakeholder feedback. As in Transnet's circumstances, it is likely that many proposed price tariffs will be contested, which may delay the implementation thereof.

Ultimately, the principles in the Act, if implemented effectively, coupled with the increased regulatory oversight of the Regulator, and with due consideration to industry stakeholders, may assist in eliminating market abuse by monopolies and corruption, as well as increasing competition and transparency.

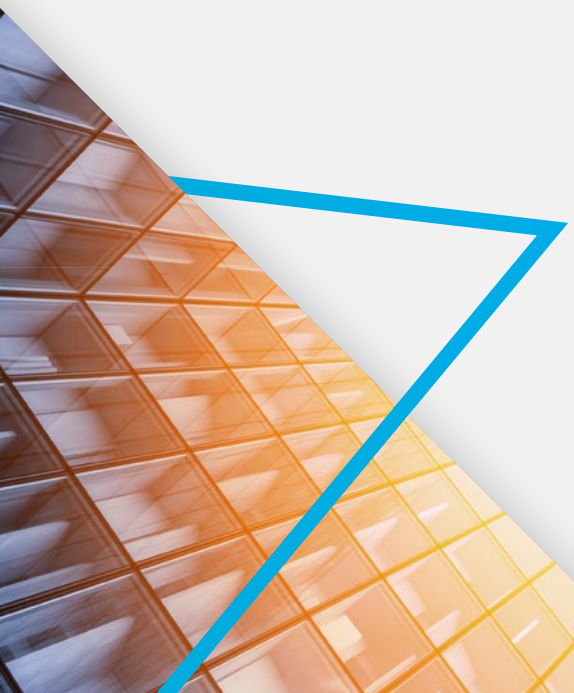
The Act is ambitious in its scope and represents a significant step towards achieving rail reform in South Africa, as it is one of three instruments outlining implementation of the reform, in addition to the National Rail Policy (adopted by Cabinet in 2022) and the Freight Logistics Roadmap.

The underlying principle of the rail reform is liberalisation and the opening of the door to private investment, which if achieved, can reduce Transnet's historic debt, increase freight volumes in the rail network, reduce transport costs for the public and ultimately expand and improve the economy.

Vivien Chaplin and Gaby Wesson



The energy to compete (for grid capacity)



The legislative landscape governing electricity generation and supply has undergone tremendous change over the last couple of years – from the amendment of Schedule II of the Electricity Regulation Act 4 of 2006 (ERA) to exempt certain generators of power from generation licensing requirements to Eskom publishing the Interim Grid Capacity Allocation Rules (IGCARs) to better govern the grid connection application process, especially in grid constrained areas.

To recap: Owing to grid capacity constraints in the Cape Provinces, only 1,000 MW out of the possible 5,2 GW was awarded under Bid Window 6 of the Renewable Energy Independent Power Producer Programme (REIPPPP), comprising only of solar photovoltaic new generation capacity. As a result, and to better regulate the grid capacity allocation process, Eskom published the IGCARs in July 2023, which shifted the process from a 'first come, first served' approach, to 'first-ready, first served'. In terms of the IGCARs, Eskom will only allocate grid capacity and issue a budget quote for grid connection to electricity generation projects that are 'shovel-ready'.

Further, to allow for greater uptake of new generation capacity from wind in the shorter term, curtailment was introduced as a proposed intervention measure under the Grid Connection Capacity Assessment 2025 Addendum (GCCA 2025 Addendum), published in January 2024. The intention is to implement 10% curtailment on present and planned operational wind energy generation facilities to open 2,680 MW of grid capacity in the Western Cape, and 790 MW in the Eastern Cape.

In the wake of Bid Window 7 of the REIPPPP, the industry has been eager to understand (i) if and how the IGCARs will assist in managing grid capacity allocation; and (ii) whether any of the capacity made available through curtailment per the GCCA 2025 Addendum would be exclusive to projects participating in the REIPPPP.

However, on 6 May 2024, Eskom submitted an application to the National Energy Regulator of South Africa (NERSA) in terms of section 21(2) of the ERA, seeking NERSA's approval to reserve and/or preserve grid connection capacity in favour of any project procured in terms of a ministerial determination published under section 34 of the ERA (Section 34 Projects) at the expense. NERSA published a consultation paper on the application on 18 May 2024 (consultation paper), setting out Eskom's motivation for the application, enclosing the application, and requesting input from stakeholders.

Objectively justifiable and identifiable differences

Section 21 of the ERA regulates the powers and duties of a licensee and expressly provides in subsection (2) that a licensee may not discriminate between customers or classes of customers regarding access, tariffs, prices and conditions of service, except for objectively justifiable and

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identifiable differences approved by NERSA. Based on the consultation paper, Eskom, as the holder of transmission and distribution licenses in terms of ERA, intends to implement such proposed just discrimination as follows:

"i. Preservation: In circumstances where a generation connection capacity assessment identifies available grid on the network and a public procurement programme is contemplated per section 34 of the [ERA] and such a programme shall make use of/or is intended to make use of the identified grid connection capacity. Preservation implies that Eskom shall hold in abeyance allocation of such capacity, for such time as may be necessary, for the sole benefit of, and exclusive allocation towards, the public procurement programme.

ii. Reservation: In specific congested areas of the network where there is limited grid connection capacity, such capacity shall be reserved for projects in the ongoing public procurement programmes at the expenses of affected customers. Colloquially, public IPP projects will be moved to the front of the queue and thus prioritised over private IPP projects."

According to the application, there are objectively justifiable and identifiable differences between private and public market IPPs that warrant these proposed interventions, including the following:

- To ensure the success of public energy procurement programmes, including REIPPPP, and protect public interest in such programmes.
- Since the amendment of Schedule II of ERA, Section 34 Projects are unable to compete with private projects, which are *"moving at a much faster pace to secure grid connection capacity and bring new generation capacity online"*.
- Eskom has a legal duty to support Section 34 Projects and ensure the realisation thereof.

The consultation paper and application both also raise other relevant legal points that must be carefully scrutinized or considered, including whether a generator qualifies as a customer as contemplated under section 21(2) of the ERA.

For purposes of making a decision, NERSA invited stakeholders and members of the public to submit their written comments on the consultation paper for the application by 17 June 2024, with a public hearing scheduled for 5 July 2024.

The application is understood to have informed the further extension of the REIPPPP Bid Window 7 submission date from 30 May 2024 to 15 August 2024. This has caused further frustration to bidders, developers and investors as they have incurred significant costs in order to ensure that their participating projects are bid ready in legitimate expectation that there is sufficient grid capacity available due to the implementation of the IGCARs and other interventions, including curtailment.

That being said, if granted, the application will also have significant implications for the private commercial and industrial market, which will seemingly have no certainty or preference as to grid capacity allocation now or in the future.

Alecia Pienaar and Deepesh Desai

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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