

Cost Recovery Rules (CRR) for Independent Transmission Projects (ITPs)

In terms of the Electricity Regulation Act, 2006 (Act No. 4 of 2006), as amended, the National Energy Regulator of South Africa (NERSA) has prepared rules to give effect to the recovery of costs associated with the procurement of transmission services from the Independent Transmission Projects (ITPs) falling under this Act. The document, 'Cost Recovery Rules for ITPs', which contains these Rules, is hereby promulgated. Electronic copies of the document may be downloaded from www.nersa.org.za.

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EXPLANATORY MEMORANDUM

The provisions of the Electricity Regulation Act, 2006 (Act No. 4 of 2006) ('the Act'), as amended, have introduced the principle of establishing transmission infrastructure through a section 34 determination. This permits private investment in the development and operation of transmission infrastructure system. Since private transmission infrastructure investment would be a new phenomenon in the South African context, there is a need to ensure project bankability and assurance of cost recovery by the Independent Transmission Projects (ITPs). To achieve this and to promote regulatory certainty, the Energy Regulator has developed and approved these rules, which are consistent with the Act, for the purpose of cost recovery by the buyer or user, that will clearly and transparently set out the following:

1. The process to be followed by the buyer in seeking the approval of costs incurred under the transmission service agreement (TSA)
2. The process to be followed in assessing the principle of efficient risk transfer in the transmission service agreement and the mitigation rules in relation to the buyer
3. The factors that should be considered in assessing:
 - a) the affordability of the proposed ITPs;
 - b) the allocation of financial, technical and operational risk between the buyer and the ITP;
 - c) the anticipated value for money to be achieved by the ITP; and
 - d) the asset sharing cost implications where the ITP and National Transmission Company South Africa (NTCSA) are sharing infrastructure, e.g. transformation infrastructure
4. All such matters as are necessary to give effect to these rules.

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Rules

1 DEFINITIONS

In these rules, any word or expression to which a meaning has been assigned in the regulations, shall have the meaning so assigned, unless the context indicates otherwise.

‘Act’ means the Electricity Regulation Act, 2006 (Act No. 4 of 2006) as amended.

‘Buyer’ means the person designated by the Minister, as contemplated in section 34(3)(d) and (e) of the Act, as a buyer of electricity transmission infrastructure, which is the subject of a determination.

‘Determination’ means a determination made by the Minister in terms of section 34(1)(b), read with section 34(3) and (4) and, where applicable, section 34(12), of the Act.

‘Energy infrastructure project’ means a project contemplated in section 34(12) of the Act.

‘Government’ means the Government of the Republic of South Africa.

‘Hedging costs’ mean costs related to the purchase and administration of hedging instruments. These costs would typically include direct payments to intermediaries (those that effectively sell hedges) and any contingent liabilities emanating from mark to market accounting rules and/or collateral requirements, and indirect costs of administration of the hedging activity by the purchasing utility.

‘Independent Transmission Project (ITP)’ means a private party, selected pursuant to a procurement process specified in a determination, to establish transmission capacity on the basis that the transmission capacity in question will be made available to a user or purchased by a buyer.

‘Integrated Resource Planning (IRP)’ means a public national planning process and framework within which the costs and benefits of both demand- and supply-side resources are evaluated to develop the least total-cost mix of utility power generation resource options, risk adjusted for probability and government policy.

‘National Treasury’ means the National Treasury established by section 5 of the Public Finance Management Act, 1999 (Act No. 1 of 1999).

‘Organ of state’ has the meaning assigned to it in section 239 of the

Constitution of the Republic of South Africa, 1996.

'Private party' means a person, consortium or joint venture in which the Government or other organs of state do not hold a controlling ownership interest, either directly or indirectly.

'Procurer' means the person designated by the Minister in a determination, as the person responsible for the preparation, management and implementation of the activities related to the procurement of transmission capacity, including the negotiation of the applicable transmission services agreements, which person may or may not be the buyer or user.

'Transmission capacity' means the electricity transmission infrastructure and associated activities that are the subjects of a determination, and which may include the design, construction, funding, management, maintenance or operation of such electricity transmission infrastructure.

'Transmission Development Plan' means the transmission development plan applicable at the date of publication of a determination by notice in the *Gazette*.

'Transmission Service Agreement' means the agreement to be entered into between the Project Company and the Buyer, under which the Project Company undertakes to provide transmission services (including the availability and performance of the transmission assets), in accordance with the terms, standards and services as set out in the ITP Procurement Programme.

'TSO SOC' means the Transmission System Operator SOC Limited to be established in terms of section 34A of the Act, and for the period prior to establishment of TSO SOC, the National Transmission Company South Africa SOC Limited.

'User' means a person designated by the Minister as contemplated in section 34(3)(d) and (e) of the Act, as a user of electricity transmission infrastructure, which is the subject of a determination.

'Value for money' means that the transmission capacity procured according to a determination results in a net benefit to the buyer or user, as the case may be, or to the Government, having regard to cost, price, quality, quantity, risk transfer, social and economic benefit, or a combination thereof.

2 OBJECTIVES

2.1 The objects of the Act are to:

- (a) achieve the efficient, effective, sustainable and orderly development and operation of electricity supply infrastructure in the Republic of South Africa;
- (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;
- (c) facilitate investment in the electricity supply industry;
- (d) facilitate universal access to electricity;
- (e) promote the use of diverse energy sources and energy efficiency;
- (f) promote competitiveness and customer and end-user choice; and
- (g) facilitate a fair balance between the interests of customers and end users, licensees, investors in the electricity supply industry and the public.

2.2 All of the above must be taken into account when making rules for assessing and determining the conditions under which transmission service costs will be recovered by a licensee.

2.3 A set of objectives encapsulating these objects of the Act is re-articulated for these rules, namely to:

- a) enable an efficient licensee to recover the full cost of the licensed activity, while also allowing for a reasonable return proportionate to the associated risk;
- b) ensure the financial viability of the sector and attract investments by ITPs, inclusive of their supporting lenders in terms of financial viability on long-term contract arrangements and surety of their investment;
- c) promote transparency, consistency and predictability in regulatory approaches and minimise perceptions of regulatory risks;
- d) give regulatory certainty to customers in terms of the impact on tariffs;
- e) ensure availability of electricity to consumers on an efficient and cost-effective basis; and
- f) promote competition, efficiency in operations and improvement in quality of supply.

3 BACKGROUND

- 3.1 The NTCSA's Transmission Development Plan (TDP) (2024–2033) outlines the transmission infrastructure that will be required to ensure security of electricity supply in the medium to long term. Expanding and modernising transmission infrastructure is vital for South Africa's energy transition and economic growth.
- 3.2 In December 2023, Government approved the ITP Programme to allow private sector participation in the development, financing, construction, and operation of new transmission infrastructure under a robust and transparent regulatory framework. This initiative aims to support the NTCSA in expediting the rollout of transmission infrastructure and integrating new generation capacity, including renewable energy.
- 3.3 Since private transmission infrastructure investment is a new development in the South African context, there is a need to guarantee project bankability and secure cost recovery for the ITPs. To achieve this and ensure regulatory certainty, the Energy Regulator has established these rules in accordance with the Act for the purpose of cost recovery by the buyer or user.

4 LEGAL RATIONALE FOR THESE RULES

- 4.1 The ERA, as amended, entrusts the Energy Regulator with the powers to approve tariffs, and such is linked to a person who is a holder of a licence. The developments brought about by the amendment of the ERA require the Energy Regulator to respond to the requirements within the frame of the law.
- 4.2 Section 34(3) sets out the paradigm shift in the determination space by the Minister to recognise the role that the private sector can play in the space, while remaining linked to the national interest. The law is not restrictive to such exercise of power by the Minister, and the role of the Energy Regulator becomes an independent complementary role to enable the effective implementation of such a determination.
- 4.3 Section 15(1)(a) obligates that the Energy Regulator, when approving tariffs, must enable an efficient licensee to recover the full cost of the licensed activity. A variety of regulatory instruments have been developed to address the issue of efficiency. These rules are not aimed at formulating a path distant from those documents, but strives to link them to the activities of section 34.
- 4.4 Section 15(1A) obligates the Energy Regulator, when approving tariffs, to be cognisant of the IRP and the TDP. These Rules are also aimed at closing the gap in the consideration of costs that require incorporation into tariff approval.

- 4.5 In the *Borbet v NERSA* case para 87, the Supreme Court of Appeal ventured into the space to deal with efficiency, wherein the court provided that ‘according to the court below the efficiency and prudence of the IPP contracts should be checked before and after contracts were concluded’. This reasoning by the court entrenches the duty and obligation that the Energy Regulator has towards its mandated obligation.
- 4.6 These draft Rules will form part of the beginning of the implementation of regulatory instruments that will provide predictability, assurance and certainty to the industry and when the Minister considers initiating a section 34 process. Section 4(a)(ii) mandates the Energy Regulator to regulate prices and tariffs through rules. The understanding of the details of the section is that it is aimed at insulating the lawfulness of the decision taken within a means that can be evaluated (rationality), because the outcome is an administrative action.
- 4.7 Section 35(3)(k) provides the Energy Regulator with tailoring powers to areas that the ERA, as amended, may not have specifically identified as requiring rule development, but are areas that the Energy Regulator may be required to make a decision on. The nexus of section 15(1) and (1A) gives the Energy Regulator the powers, therefore these Rules are not expanding on the scope of the Energy Regulator outside of the ERA, as amended.

5 TYPES OF PROJECTS

- 5.1 These Cost Recovery Rules apply to Transmission Infrastructure Projects as defined in section 34 (12) and (15) of the Act.
- 5.2 The transmission capacity provided by these projects will be sold by the ITP according to its licence to operate a transmission facility. As a condition of the licence, purchases from ITPs will be regulated, and as a result, efficiently incurred costs will be recovered as part of the regulated licensed activities, including a reasonable risk related return.

6 PRINCIPLES

- 6.1 The main principle is that transmission capacity purchases governed by these rules should be acquired by the buyer in a cost-effective manner.
- 6.2 This overarching principle is central to each of the objectives set out in section 2 and has been demonstrated in numerous jurisdictions to offer a reliable and practical benchmark for evaluating the long-term benefits to customers from transmission capacity purchases.
- 6.3 In assessing the cost-effectiveness of transmission capacity purchases, the work done in the development of the Transmission Development Plan from which the projects originate, will be relied on. The Transmission Development

Plan is compiled based on principles set out by NERSA in the South African Grid Code, section 7 of the Network Code and is an official foundation for developing any cost-related assessment. In addition, cognisance will be taken of the budgeted project costs in assessing the value-for-money proposition.

- 6.4 The principle of cost-effectiveness will be applied to all independent transmission projects. This includes aspects related to transmission lines, transformation infrastructure, and the refurbishment of infrastructure by ITPs. If deemed cost-effective, and providing value for money, and in accordance with the other conditions specified in these rules, the costs associated with increasing transmission capacity will be passed on to customers via the appropriate tariffing process.

7 GOVERNMENT POLICY ON TRANSMISSION CAPACITY PROCUREMENT

- 7.1 Government policy related to procurement of transmission capacity from the private sector will be taken into consideration with regard to the recovery of costs stemming from the transmission services agreements. Other relevant government policies would also be taken into consideration.

8 TRANSMISSION DEVELOPMENT PLANNING

- 8.1 As provided for by the Act, this will be done having regard for the need for new transmission capacity in the TDP and any future transmission regulations that may be promulgated.
- 8.2 The Minister may commission the undertaking of a feasibility study in respect of the transmission capacity, which may be the subject of a section 34 determination.

9 BALANCED RISK ALLOCATION

- 9.1 Risk allocation and transfer is an essential component of a TSA. TSAs will be assessed with regard to the principle of efficient risk transfer where the party best able to manage specific risks is allocated those risks. NERSA will assess the transfer of specific risks defined in TSAs to ensure this principle is met.
- 9.2 It is advised that the parties to an agreement should engage with NERSA with regard to key aspects of a TSA in the early stage of project development to ensure that the design of a TSA is in accordance with appropriate principles of risk transfer and that the correct parameters are set.

10 APPLICATION

- 10.1 These rules are to provide a defined assessment framework for ITP costs. The aim in this regard is to provide a framework that is sufficiently robust to be applied on a consistent basis across a range of project types.
- 10.2 In applying the principles set out in this document, these rules are to apply to all projects procured under a section 34 determination.

11 EXCLUSIONS FROM THE RULES

- 11.1 These rules are not applicable to infrastructure projects developed by the NTCSA and projects outside of the section 34 determinations.

12 AUTHORISATION

- 12.1 These rules set out the process and assessment criteria under which the buyer's transmission capacity purchase cost recovery will be authorised by the Energy Regulator.
- 12.2 On application from the buyer, the Energy Regulator will undertake an assessment of the TSA in question. The buyer will be expected to provide all relevant information and commercial agreements documentation to the Energy Regulator as requested.
- 12.3 Having regard for the assessment criteria set out above, the Energy Regulator will make its decision within 90 days of receiving an application and all relevant information.
- 12.4 If authorised by the Energy Regulator, costs incurred by the buyer will be allowed as a pass-through for the duration of the TSA.

13 RECOVERABLE COSTS

- 13.1 Where authorised by NERSA, transmission capacity costs will be recovered by the buyer as part of its annual allowable revenue through the transmission tariff. Recoverable costs include the following:
- 13.1.1 Transmission capacity payments made by the buyer to the ITP
- (a) Transmission capacity payments made to the ITP including without limitation, and other payments as set out in a TSA inclusive of the indexation of such payments as prescribed by a TSA.
 - (b) NERSA and the Independent Procurement Office will cooperate to make sure that the bidding process yields the most efficient costs possible and delivers value for money. NERSA will not take

part in the bid adjudication, but will participate in the process of the formulation of the bidding documents, to ensure that the principles of section 15 of the ERA, 2006, as amended, are adhered to.

13.1.2 Hedging costs

These include costs incurred prudently by the buyer and/or an ITP in taking out hedging positions to mitigate, or in obtaining insurance or otherwise indemnifying itself and/or themselves against the risks allocated to the buyer and/or ITP under a TSA including, without limitation, the costs of hedging its and/or their exposure in respect of commodity and foreign exchange risks linked to the repayment of debt.

13.1.3 Administration of TSAs including professional services

These include contract management services required to develop, manage, monitor and account for the buyer's payment and financial obligations under the TSA.

13.1.4 Termination costs

These are costs to the buyer associated with the termination, by the ITP, of the Transmission Services Agreement, for any reason.

13.1.5 Other costs

Any other costs not covered above that are prudently/efficiently incurred will be allowed by the Energy Regulator as TSA costs and they will be passed through.

14 NO DOUBLE COUNTING OF COSTS

The buyer shall not be entitled to recover, through its allowed revenue limit, costs that it has already recovered or been compensated for via another avenue. All double-counted costs shall be excluded from any cost recovery compensation and, if already recovered, shall be addressed through appropriate ex ante rules.

15 RECOVERY OF PASS-THROUGH COSTS

Recoverable costs of transmission capacity purchases will be factored into the buyer's projected allowable revenue requirement using costs as projected per the TSA at the time of submission of the buyer's revenue application.

16 DURATION

An authorisation for transmission capacity purchase cost recovery should remain valid for the duration of the relevant TSA.

17 TRANSFER

The protections offered by these rules will transfer to the relevant licensee in the case of a restructuring and/or transfer of rights and obligations of a TSA.

18 APPEAL PROCESS

As set out in the National Energy Regulator Act, 2004 (Act No. 40 of 2004), any person may institute proceedings in the High Court for the judicial review of an administrative action by the Energy Regulator in accordance with the Promotion of Administrative Justice Act, 2000 (Act No. 3 of 2000).

19 SECURING ITP PAYMENTS

The buyer must ringfence the revenue allocated to ITPs and allocate the required funds for the payment of the ITPs.

20 EFFECTIVE DATE

These rules are effective from the date of approval.

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