Summary of Submissions on "Regulatory Guidelines for Cross Border Power Trading in the SADC Region"

April 2010

Introduction and Background

In April 2008, RERA was given a mandate from the SADC Energy Ministers to help address major regulatory constraints facing cross-border power trading in Southern Africa (Record of 29th Meeting of SADC Energy Ministers, 30 April 2008, Kinshasa). To fulfil this mandate RERA has prepared a set of guidelines for national regulators in SADC to be applied in making regulatory decisions on major cross-border trading initiatives ("the guidelines").

The guidelines serve as a first concrete step for harmonising national regulatory regimes for major, cross-border power projects. The guidelines aim to establish a consistent basis for making regulatory decisions in the region that achieve the objective of providing reliable electricity services at the lowest possible cost. RERA considers that the guidelines help to provide an enabling framework for cross-border trade and electricity sector investment by ensuring greater certainty for investors and improving the security of supply provided to electricity consumers.

To ensure that the guidelines adequately reflect the realities facing national regulators, in late 2009 and early 2010, RERA has consulted with stakeholders in the SADC region to gather their views on the guidelines. Formal, written comments were received from twelve stakeholders. This document provides a summary of the submissions received from stakeholders on each guideline, and discusses the changes that RERA has made to the guidelines to reflect stakeholder concerns.

In late March and early April 2010, RERA consulted with stakeholders in Botswana, Namibia, South Africa, Zambia and Zimbabwe as part of an outreach programme on the Guidelines. A number of further changes to the Guidelines were made to reflect feedback from these stakeholders.

The guidelines will continue to be refined, but now reflect the views of a wide cross-section of stakeholders that contributed to the consultation, including project developers, buying and selling utilities, financiers, government Ministries and national regulators.

Comments on Definitions

During the outreach programme a number of stakeholders expressed confusion over the definition of “captive customers”. This has been clarified to make it clear that captive customers are those whose prices are set or controlled by a Regulator (i.e., a national regulatory entity), and the terminology has been changed to “price-regulated customers” to reflect this new definition. The definition of “cross border agreement” has been amended to specifically exclude trading on the SAPP day ahead market (DAM).

Comments on Introduction

As a result of the outreach program consultation, changes were also made to clarify the relationship between the Guidelines and SAPP protocols and agreements. It is now clear that in the interests of harmonisation, Regulators will give substantial weight to SAPP agreements and resolution, particularly where they arise from extensive consultation with stakeholders and are clearly efficient and non-discriminatory. This point is also now emphasized in Guideline 1.2
The Guidelines have also been amended to apply to all cross-border agreements, excluding the DAM), but now note that small and short transactions should be reviewed in a more streamlined and less intensive manner than major long term transactions.

Comments on Guideline 1 – Regulator’s Powers and Duties in Cross-border Trading

Guideline 1 sets out the regulatory decisions covered by the guidelines, which include licensing, approving power purchase agreements, allowing purchasing costs to be reflected in retail electricity tariffs, approving transmission charges and mandating access to transmission facilities. Guideline 1 also recognises that the regulator will need to have regard to Government policy, particularly on issues concerning power sector reform, security of supply and the environment.

One submission made by a national utility expressed the view that the guidelines should not address Government responsibilities, and should instead focus narrowly on regulatory decisions. RERA agrees that the guidelines should focus on regulatory decisions, and the guidelines are not intended to apply to Government policy decisions. However, certain policy areas will have a significant impact on the decisions that regulators need to make. The purpose of Guideline 1 is to clearly specify the decisions that are directly addressed in the

guidelines (that is, regulatory decisions), and then to note the Government policy decisions that will have a significant bearing on regulatory decisions.

RERA's view is that providing guidance on the distinctions between regulatory decisions and Government policy is important in SADC. In many countries in the region, regulatory and policy functions are carried out by the same entity, typically a Government Ministry. This can make it more difficult for stakeholders to observe whether the actions of the Ministry relate to its policy making functions, or are in fact regulatory decisions. The guidelines help to clarify this issue, and should be applied to regulatory functions and processes regardless of which body undertakes these responsibilities.

Although the term "Regulator" is defined broadly in the guidelines to include independent agencies, Government Ministries or the Ministers themselves, RERA accepts that the guidelines need to be clear on how certain decisions might apply if the regulatory decision-maker is also responsible for government policy. Accordingly, where this issue arises in the guidelines, edits have been made to ensure that the meaning of the guideline is clear.

Other submissions from privately-owned project developers stressed that other areas of government policy are relevant for making regulatory decisions, including the speed of migration to cost-reflective tariffs and conditions for black economic empowerment. RERA agrees that these issues are important, and has added these areas to policy issues listed in Guideline 1.

As a result of the outreach programme consultation, changes have been made to Guideline 1.2 to clarify that a Regulator's "approval" of cross-border agreements is not a general approval of the entire contract, but a specific approval for issues within the Regulator's mandate, such as system security implications or safeguarding the interest of price-regulated customers through, for example, a decision on the pass through of power purchase costs in the case of an import..

Comments on Guideline 2 – Compatibility of regulatory decisions

Guideline 2 formally recognises the value of consistent and compatible regulatory decisions in SADC. Given the differing regulatory environments throughout the region, harmonisation does not mean that regulatory approaches in different countries need to be exactly the same, but rather that the regulations need to be able to work together.

Submissions were generally supportive of the objective of the guideline to ensure compatible decisions, or at least to promote a compatible decision making framework. This reflects the general support RERA has received from stakeholders for its efforts to build a consistent and credible regulatory environment through the guidelines.

As a result of the outreach programme consultation, changes have been made to Guideline 2.2 to acknowledge the role of SAPP and thus take into account SAPP operating agreements between member countries and other agreements for regional system operations and control area services.

Comments on Guideline 3 – Timing of regulatory interactions

Guideline 3 addresses the timing of regulatory interactions during the project development process, both before and after an application has been filed for a regulatory decision. The guideline also establishes a “propose-respond” process for regulatory decision-making, which requires applicants to define the scope of their requested approvals and regulators to make decisions on the basis of applications.

There was a mixed response to this guideline. In response to Guideline 3.5, one respondent believed that regulators should not be invited to negotiations, as this may derail the process. Other submitters encouraged early meetings involving the regulator as a way to ensure a common understanding, and gain non-binding opinions from the regulator that might help the process.

While regulatory decisions often occur *ex-post* (after a transaction has been concluded), there are some important advantages to obtaining early indications national regulators on some issues. Allowing the parties to meet with the regulator before a formal application is filed can reduce the risk facing project sponsors and national utilities that investment costs may not be recovered through regulated tariffs. This will help to enable lenders and investors to commit funding on satisfactory terms in advance of final regulatory decisions.

Guideline 3.5 states that the regulator “may join the negotiations as an observer” only “at the joint the request of the parties”. Accordingly, any party to the negotiation can veto the presence of a regulator if they believe it will inhibit the negotiation process. Conversely, if the parties to the negotiation believe that early involvement in the negotiations by the regulator will be beneficial they can agree and the regulator can attend as an observer. The Guideline therefore does not force any party to accept the presence of the regulator.

The guidelines have been modified to explicitly allow the regulator not to attend, even if all other parties accept its involvement, on the basis that the regulator perceives a conflict of interest or believes attendance would compromise their regulatory decision making processes.

Guideline 3.7 attracted comment that regulators should be required to meet with counterpart regulatory agencies on the other side of cross-boarder transactions. While discussions with counterpart regulatory agencies are likely to be useful and productive, mandating meetings could introduce an additional procedural step that holds up progress. However, RERA believes that meetings with counterpart

regulatory agencies should be explicitly encouraged, and the guideline has been amended accordingly.

One submitter suggested that Guideline 3.8 should specify a timeframe for making regulatory decisions. While we agree that that decision making timeframes should be specified, this will difficult to achieve in these guidelines. Regulatory agencies in SADC have different resources and external pressures that can impact on their abilities to make timely decisions. The guideline has been clarified by adding that timeframes for decision making should be specified at the start of a regulatory decision making process to provide additional regulatory clarity and certainty.

There was some concern expressed that Guideline 3.9 gives wide discretion to the regulator by enabling to accept, reject or require modifications to a regulatory application. RERA does not share this concern as the guideline does not confer additional discretion on the regulator, but rather provides certainty by limiting possible regulatory responses following an application.

A respondent suggested that regulators should be explicitly required to give reasons before rejecting an application. RERA believes that this is addressed in Guideline 9 which states that once a regulatory decision has been made the regulator will publish “A full discussion and explanation of the reasons for the decision”. For the avoidance of doubt, Guideline 9.1 has been redrafted to make it clear that the analysis and reasons for a decision must be published at the same time as the decision.

Another submitter suggested that regulators should be able and indeed encouraged to seek qualified advice on all significant regulatory actions, not just during pre-application meetings as inferred by Guideline 3.3. RERA agrees and has clarified the drafting of the guideline.

The issue of confidentiality was raised by a respondent who believed that if either party requests confidentiality of information disclosed during an application, the onus should shift to the regulator to show that disclose of information would be in the public interest. RERA disagrees with this view, and proposes to retain the current wording of Guideline 3.6 (and Guideline 9, which also deals with regulatory release of information). RERA considers that it is extremely important that regulatory decisions be open and transparent, although the public’s right to understand the detail of the transaction needs to be balanced against the proponent’s desire for confidentiality. RERA also believes that it would be an unacceptable burden on regulators to require them to make the case for disclosure. Instead, RERA believes that the parties requesting confidentiality should have the responsibility of showing why the information should not be released, and the regulator can then make an informed decision based on the merits of the case presented.

As a result of the outreach programme consultation, Guideline 3.5 now states that “a Regulator may *attend* the negotiations as an observer”, rather than *“join”*. This change was made in response to a comment that the use of “join” could be interpreted to mean that the Regulator is an active participant in the negotiations.

Comments on Guideline 4 – Licensing

Regulatory statutes in SADC countries generally require that the regulator licenses power generation, transmission, distribution, imports and exports. Some countries also require any trading of electricity to be licensed. The legal framework typically makes it an offence to carry out these activities without a license, granted by a designated government agency. Guideline 4 addresses all issues related to licensing cross-border trading activities—the conditions to be satisfied to obtain a license, the contents of the license, the timing of decisions on licensing and how licenses will expire.

Licenses are simple regulatory tools that can be written in plain language and tailored to the circumstances of the licensee and the requirements of the regulator. The conditions contained in the license do not focus on controlling entry to the electricity sector, but seek to influence the behaviour of the licensee over the term of the license. At a high level, their objectives are to protect the consumer and attract investment (recognizing the tensions between these objectives). Ministries and regulators need to be sensitive to investors’ perceptions of political and regulatory risk (and uncertainty) in the way that license conditions are imposed.

Guideline 4.1(d)(i) attracted unfavourable comment from entities with a focus on commercial development of cross border projects. This guideline requires regulators to check if resources proposed to facilitate an export-oriented electricity supply project are needed to meet domestic demand, and to give domestic providers the first opportunity to buy the power provided. Developers indicated that the test in Guideline 4.1 (d)(i) is too onerous—essentially most countries in the region have a need for more power domestically. These submitters believe that the guideline raises the prospect that licenses will not be granted for commercial export projects while there was unmet domestic demand, potentially stifling cross-border trading.

RERA agrees that a license to export should not be refused unless there is a firm and binding offer from a domestic buyer made on the same or better terms as the proposed deal, including the credit rating of the buyer. In other words, a commercial export license should not be refused on the basis of unmet domestic demand and a hypothetical domestic purchaser. Guideline 4.1(d)(i) has been amended to make it clear that an export license should only be refused if there is a firm domestic offer on the table that is equivalent (or better) in all respects.

The issue of the political and regulatory risk associated with license termination also attracted comment in RERA's consultation with stakeholders. While RERA believes that Guideline 4.6 in no way creates any unilateral grounds for a regulator to terminate a license, RERA accepts that for the avoidance of doubt the Guideline should make it clear that any termination of a license by a Regulator should only be on grounds and on conditions clearly specified in the license at the time of issuance.

Similarly, respondents commented on whether licenses should automatically terminate if they are not used. One view is that because the timing of these projects can be difficult to predict, licenses should remain in place in order to minimise commercial risks. An alternative point of view, taken by two respondents, is that if security of supply is harmed through the license remaining in place, or the license is sending the wrong signals, or if licensee fails to perform, then the license should be terminated. While RERA agrees that timing of these projects is an issue, "evergreen" rights associated with a project that is not proceeding can also create problems for other new projects. For example, a licensed project may be allocated some measure of transmission capacity for export. If the project is obviously not proceeding, there needs to be some process to re-allocate that transmission capacity to new projects that are proceeding.

RERA has proposed a compromise under Guideline 4.6 where the license will be valid for a specified time period in which the project must commence construction and file a schedule for completion. For example, a license condition may specify that the underlying project must commence within five-years, with the option of re-applying to the regulator to extend in this time period. In this way, the project proponent has certainty (within a time period), but the rights attached to projects that never proceed will ultimately expire.

Comments on Guideline 5 – Importing countries

Guideline 5 sets out how regulators in importing countries will review cross-border agreements to help to ensure that the power purchased provides enhanced reliability and value for money. Typically, Regulators in an importing country will have the greatest level of regulatory involvement in a cross-border transaction. This is because of the proposed power purchase will have direct impacts on the buying utility and the price for electricity paid by domestic customers.

Guideline 5 is made up of two components. Guidelines 5.1 and 5.2 require the regulator to consider the impact of the proposal on security of supply in the importing country. Guidelines 5.3 to 5.8 only apply where we supplied i.e. these guidelines do not apply to the transactions between sellers, captive customers and large buyers consuming power for their own use, such as industrial customers. Pricing and the balance of risks between large buyers and sellers can be assumed to be fair and reasonable, and not require regulatory intervention. However, where captive customers are involved and the costs of the cross

border power purchase will pass through into regulated tariffs for small customers, the regulator will be interested in the overall impact of the buyer's costs of the imported power.

A number of respondents rightly pointed out that even the technical aspects covered by Guidelines 5.1 and 5.2—transmission capacity and security of supply — are complex. For example, determining if transmission capacity is available and evaluating the impact of the proposed transaction on the transmission system is one of the major and more difficult tasks for the regulator.
The remainder of Guideline 5 attracted the most comment from respondents—many had comments on the regulator's consideration of the competitiveness of the bidding process and requirement to evaluate the value for money of the transaction for captive customers.

RERA acknowledges that this is probably the most difficult area of the guidelines. Unsolicited bids may well be the norm for some time and regulators need to be pragmatic when assessing the value for money of a commercial import proposal against a theoretical benchmark for which there is no project and no proponent. However, in the interests of efficiency and transparency some degree of "value for money" benchmarking needs to be carried out by the regulator. Furthermore, the guidelines give the regulator wide discretion in determining "value for money". While the guideline does not fully specify competitive processes for procurement, a number of respondents felt that Guideline 5.5 was too prescriptive. These respondents suggested that a concept of good procurement being "fair, equitable, transparent, competitive and cost-effective" would be more appropriate. RERA sees merit in this approach and has redrafted Guideline 5.5 to be more focused on the outcomes sought from a competitive process.

As a result of the outreach programme consultation, Guideline 5.8 now makes it clear that a Regulator is not "approving" the cross-border agreement in its entirety, but rather making a determination that the agreement provides value for money and the buyer is entitled to have the purchase costs reflected in regulated tariffs to price-regulated customers such as most residential and commercial customers. Guideline 5.2 now specifically references conformity with SAPP operating agreements between member countries as a criterion for regulatory review.

Comments on Guideline 6 – Exporting country

The regulator in a country exporting power will have an interest in ensuring that the cross-border transaction is reasonable, although the scope of a regulatory review of export PPAs will generally be narrower than for import PPAs. This is because sellers have strong commercial incentives to maximise the revenues earned under cross-border transactions, and to minimise the risks accepted in export PPAs.

Guideline 6 sets out the considerations to be taken into account in regulatory decisions relating to export agreements—including the scope of the regulator's decision making powers, the treatment of export revenues, and the criteria for obtaining regulatory approval.

One respondent did not see a need for any guidelines for exporting countries beyond a review of transmission issues. While RERA accepts that the process for exporting countries is less intensive than importing countries, some guidelines for the regulator are needed to manage effects on the prices charged to captive customers. Other submitters noted that below-cost export pricing may lead to detriments to captive customers.

Furthermore, beyond a review of transmission issues, heavy reliance on imports may have security of supply considerations which should be reviewed by the regulator. A number of respondents commented on the difficulty in determining the cost base for export sales where under utilised or fully depreciated assets where used.

Nevertheless, while RERA agrees that determining the economic viability exporting will involve difficult issues such as the opportunity cost of fully depreciated or under utilized assets, Guideline 6.3 is intended to ensure that the seller is not imposing unwarranted costs on its captive customers. This is a legitimate concern of the regulator and RERA proposes to retain the guidelines as currently drafted.

As a result of the outreach programme consultation, Guideline 6.4 has been changed to make it clear that the Regulator is not "approving" the cross border agreement in its entirety, but instead is making a determination that it will not adversely impact national customers. Guideline 6.2 now specifically references conformity with SAPP operating agreements between member countries as a criterion for regulatory review.

Comments on Guideline 7 – Transit countries

Guideline 7 addresses the review of cross-border agreements to be conducted by the regulator in the transit country—a country through which electricity is transported from the buyer to the seller, both of which are located in other countries. Most of the provisions in Guideline 7 mirror the requirements of Guideline 6 for exporting countries, as many of the regulator's concerns will be the same. The notable exception is that the regulator in a transit country will not need to review the terms of the PPA because the contractual obligations under a PPA fall on parties that are outside the regulator's jurisdiction.

There was little comment on this area of the Guidelines beyond the useful suggestion that RERA should work more closely with SAPP on transmission issues to ensure that wheeling arrangements do not compromise security of

supply and that transmission prices appropriately value congestion. RERA intends to work with SAPP to advance transmission pricing and ancillary services for cross-boarder trading.

As a result of the outreach programme consultation, Guideline 7.2 now specifically references conformity with SAPP operating agreements between member countries as a criterion for regulatory review.

Comments on Guideline 8 – Transmission access and pricing

Ensuring transmission access and investment is a regulatory function as part of ensuring competition in generation. Adequate transmission resources will help to unlock least-cost generation resources, enabling generators to compete with each other to supply utilities and consumers.

The governments in SADC have generally supported the principle of open access to transmission to facilitate investment in generation. However, it is not yet fully operationalised in all jurisdictions, and there will be circumstances where the transmission provider also owns and develops new generation and discrimination can be a significant concern to the regulator.

The guidelines clarify that the regulator's review of transmission pricing will involve both national and cross-border transmission prices, and establish some basic principles for transmission pricing that the regulator will look for as the entity responsible for approving transmission prices in the cost of serving domestic consumers.

There were a number of submissions that stressed the importance of a standard transmission access and price structure across the region. While this would be highly desirable, RERA sees these guidelines as the first steps in harmonising these arrangements and ensuring a degree of compatibility and conformity. These guidelines help to create a workable and relatively consistent framework that will allow commercially and economically viable projects to proceed.

One respondent felt that transmission access and pricing issues should be dealt with by regulators because transmission is a monopoly requiring clear and codified access, pricing and wheeling arrangements. While transmission is a monopoly, for large-scale power import and export projects between an IPP and a major industrial users, transmission owners have reasonable incentives to negotiate—as they potentially gain substantial revenues if the project proceeds and they face the threat of bypass.

RERA believes that while regulated, open access prices, terms and conditions is a desirable long-term goal for all transmission systems in the region, these guidelines seek to achieve a consistent decision making framework where issues such as the impact of a project on regional security of supply and pricing impacts

on captive customers are considered. This is clearly only an initial step, but will help to create more certainty for investors on transmission issues.

Comments on Guideline 9 - Transparency

Transparency is essential if investors and consumers are to believe that regulatory processes and decisions are fair, credible and legitimate. The regulatory decision-making process needs to be understood by participants, which requires a conscious decision from regulators to make deliberations, decisions and reasons available for public review and comment.

Guideline 9 sets out a regulatory practice for the decision making process of regulators. A small number of submissions raised concerns about the Regulator's discretion to disclose confidential information (discussed in relation to Guideline 3).

A number of submitters commented that there should be less transparency if the transaction process is carried out by a Ministry, as opposed to a regulator. While accepting that Governments are accountable to the electorate, RERA believes that good governance practices should entail as much disclosure as is possible, without causing commercial harm to the proponents of a cross border power trading project. Accordingly, RERA proposes to draft the Guideline in a way that applies equally to Government Ministries and regulators.

As a result of the outreach programme consultation, Guideline 9.1 has been changed so that reasons for a regulatory decision may be published after a pre-determined time, rather than simultaneously with the decision. Respondents suggested that it might be necessary for a Regulator to consult with an applicant on the degree to which supporting information provided in the decision might be considered commercial in confidence by an applicant.

Other topics

A number of submissions raised more general issues, not related to specific guidelines.

a. Environmental Issues

One stakeholder was concerned that the guidelines did not seem to fully address environmental issues, and suggested that the guidelines should incorporate some measures to level the playing field for renewable sources of generation. While these issues are important, RERA believes that this is a policy issue for national Governments that cannot be adequately addressed through the guidelines.

b. Implementation of the Guidelines

Comments on the guidelines also focused on implementation. There was a suggestion that RERA should table the guidelines at an annual meeting for adopting and require each member to go through a process of adopting guidelines through internal governance structures (with timeline for doing so). While this first step has been taken, it would be difficult to for RERA to require members to make these guidelines enforceable. RERA believes that these guidelines, although voluntary, will allow workable and compatible decisions to be made by a variety of different regulatory bodies operating under their own national legislation.

To assist its members in implementing the guidelines, RERA intends to undertake a program of "on-site" technical assistance to members of RERA who request such assistance. RERA will also report back to the SADC Energy Ministers within 18 months on the extent to which the guidelines have been implemented, impediments to their implementation and proposed modifications to increase their effectiveness.

c. A Regional Electricity Regulator

Two stakeholders expressed scepticism that the "voluntary" approach of relying on individual national regulators to implement the guidelines will produce useful results. They cautioned that reliance on the separate actions of national regulators could lead to delayed and sometimes conflicting decisions that would hinder rather than help major cross-border transactions. They recommended creation of a regional electricity regulatory entity (similar to the one that was created in January 2008 by the ECOWAS Heads of State) with the clear legal authority to make binding regulatory decisions relevant to major cross-border transactions.

RERA believes that it would prudent to first implement and evaluate the voluntary approach of harmonizing and coordinating the actions of existing national regulators. If this proves to be unsuccessful, then the SADC Energy Ministers may wish to consider the creation of a regional electricity regulatory authority which could be informed by the actual experience of such entities in ECOWAS and in the six Central American countries.