



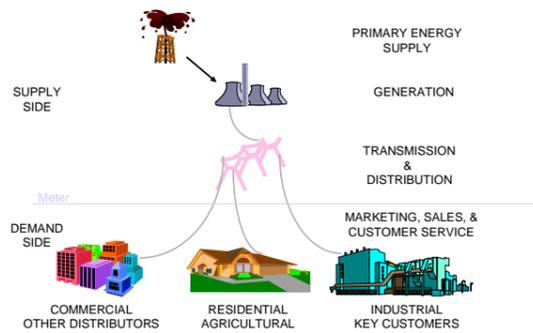
# INFORMATION ON REGIONAL ELECTRICITY DISTRIBUTORS (REDs)

## 1. OVERVIEW OF REDs: FREQUENTLY ASKED QUESTIONS

Article 1 of 6, compiled by the Electricity Control Board (ECB) to clear misconceptions about REDs & related electricity matters.



### The Supply (Value) Chain



### What was the position of the Namibian electricity distribution industry before REDs?

Namibia's electricity sector can be divided into the following main categories: (1) generation (that is the actual making/production of electricity); (2) transmission (that is the transport of bulk electricity exclusively by NamPower over high voltage lines); and (3) distribution. As the voltage on transmission lines is too high to connect customers directly, the electricity is stepped down to lower voltage and it enters the distribution system (which is a medium voltage system) and becomes the responsibility of the distribution licensees. The distribution licensee is the entity, which supplies electricity to the final consumers.

The main distributors in Namibia are Local Authorities (LAs) and Regional Councils (RCs) supplying the residents & businesses in their areas, NamPower supplying mainly farms, private farmers' schemes<sup>1</sup> and mines<sup>2</sup>.

Before the creation of REDs, there were over 70 distribution licensees in Namibia. The following are of the main problems experienced in the distribution industry (and still continue to be experienced in areas where REDs are not yet established): (a) some distributors cannot afford qualified personnel such as engineers and electricians and therefore cannot provide an efficient service to its customers; (b) credit control was ineffective with many customers not being billed or being billed wrongly eventually deteriorating to such extent that NamPower bills could not be paid with consequent disconnections; (c) much duplication of cost with each distributor having its own business systems like billing, personnel, technical resources, etc; (d) no harmonisation of tariffs with each distributor charging different tariffs; (e) limited or no maintenance of the electricity distribution network resulting in many networks being very old, in bad shape and in serious need of upgrading/replacing; (f) no financial ring-fencing of the electricity businesses of distributors – meaning electricity was lumped with other services and therefore electricity income, expenditure, profit, loss, etc were not clearly known to most distributors; (g) lack of standards on service quality, safety; etc.

It was clear that this situation could not continue and was in serious need of restructuring. If this situation is to be retained, the aims of Vision 2030 cannot be achieved.

### What is a RED?

A RED is a regional electricity distributing company tasked with supplying electricity to the residents in a specific region. A Restructuring Study completed by the Ministry of Mines & Energy (MME) in 1998 recommended that Namibia be divided into five areas and that a single electricity distributor be established for each area solely responsible for electricity distribution in that area. All the existing distributors in such area then join the RED ("no islands" allowed). The benefits of the consolidation of distribution businesses are: (a) economies of scale – duplication of costs and systems will be avoided and electricity can be supplied at lower prices; (b) uniformity of standards, tariffs, service, etc within a single RED; (c) improved capacity since the RED will be able to solely focus on its core business (i.e. electricity) and will be able to employ sufficient and suitably qualified people and systems; (d) it will not be necessary for Government to continue subsidising loss-making electricity distributors; (e) promotion of

electrification; (f) improved efficiency and financial viability of the whole distribution industry; (g) improved customer service; (h) creating conducive conditions for the achievement of Vision 2030; and (i) uplifting the rural standard of living through improved electricity service delivery in rural areas.

In order to consolidate all distribution in an area, all electricity distributors in such area voluntarily join their electricity businesses in a single entity<sup>3</sup>, which will eventually take over their distribution functions. The Namibian Cabinet has approved the establishment of REDs in Namibia in 2000.

### Who are the actual shareholders of the existing REDs?

The owners/shareholders of the RED are the before-mentioned distributors in the RED's geographic area. The various distributors undertake to transfer their electricity networks and customers to the RED. In exchange for such transfer they receive shares in the RED. Thus, apart from mines and farmer schemes, the REDs are predominantly owned by public entities (LAs, RCs and NamPower)<sup>4</sup>.

### Is a RED just another structure added to the industry at additional cost?

No. The RED is the consolidated business of existing licensees. Once all anticipated 5 REDs have been established the number of distribution licensees in Namibia will be reduced from approximately 70 to 5. In fact, due to its very nature (economies of scale and sharing of resource), it saves cost and does not add cost. Thus, the RED is not another structure but rather a substitute structure for the existing electricity distribution businesses in Namibia.

### How does the establishment of REDs impact on electricity prices – i.e. will customers pay more for electricity once the RED is established?

Electricity in Namibia has historically been cheap due to the following factors: (1) Eskom of South Africa had a surplus of generation capacity and Namibia could import (up to 60%) electricity at very low prices; (2) The loans of Namibia's main power station, the Ruacana hydropower station was paid off in the 1980s and could supplement imports also at a very low price; and (3) many distributors were not charging cost-reflective tariffs notably distribution tariffs did not include provision for future investment in infrastructure when the existing infrastructure becomes outdated. Currently there is a generation capacity shortage in South Africa and in the whole Southern Africa region. To counter this South Africa, Namibia and the region are scrambling to build new power stations, which cost considerably more than the current old, loans-paid-off power stations (presently generation cost in Namibia is 22 c/kWh<sup>5</sup>, new generation cost is about 30-40 c/kWh depending on the type of power station). In addition most of Namibia's distribution infrastructure is reaching the end of its lifetime as it was built in the 1960s and replacements and refurbishments are required urgently (most current distributors do not have the financial resources for replacements/refurbishments as these costs have not been included in the historic prices of electricity).

Thus the price of electricity is currently not cost reflective and cannot sustain the electricity industry in the long-term. Therefore a Cabinet decision (part of Vision 2030) was taken that electricity prices must be cost reflective by 2011. The reason for the gradual implementation of cost reflective prices is that the price shock of doing it in a single step would be detrimental to the electricity customers and the economy. Thus until 2011, a premium is added every year above inflation to reach cost-reflective electricity prices 2011.

In addition, the LA Surcharges<sup>6</sup> (more details on this in a future article) are also added to the RED's tariff which, when collected, are paid over to the LAs.<sup>7</sup> Thus, although

the RED (in real terms) can and will provide electricity to its customers at lower prices than the LAs and RCs could, it appears to customers that the establishment of REDs result in increased electricity prices. As explained before, these increases must be seen against their correct background and cannot be attributed to the establishment of REDs.

### What benefits are there for LAs or RCs to join a RED?

If the RED is a success, it reflects positive on its shareholders, its customers are satisfied and, once the RED shows a profit, its shareholders share in its declared dividends.<sup>8</sup> For LAs and RCs it further means that they can be assured that their electricity functions are performed by a competent entity, which can provide good electricity services and standards to their residents. LAs and RCs are major participants in REDs resulting in them being major owners (i.e. shareholders) of the RED, which they joined. As shareholders they retain ownership and interest in their transferred electricity businesses and can exercise influence thereon in line with good governance principles.

### Why are REDs not regulated through a specific Act?

REDs are established through private companies with all initial shareholding by Government-owned or public entities. The stakeholders' view (consultations during the Electricity Restructuring Study) was capturing the efficiency of the private sector while public sector retains ownership. As private companies, the REDs are thoroughly regulated by the provisions of the Companies Act, 1973. In addition, the Electricity Act regulates electricity licensees (that includes REDs) and there is included in the new Electricity Bill (more details on this in a future article) specific sections on REDs. The Electricity Bill also provides amply for subordinate rules and regulations, which will further regulate REDs. Thus the ECB and the MME are confident that there are sufficient legal instruments available to allow for the effective regulation of REDs but, should a need for more specific regulation in future be identified, further legislation on the REDs can be drafted at that stage.

### Why are some LAs and RCs opposing the establishment of REDs?

The policy of Government is that LAs and RCs should conduct electricity supply based on commercial principles, which conflicts with the traditional uses of electricity sales. It is difficult for LAs and RCs to overnight transform to such commercial principles. Traditionally LAs have been using electricity sales for their daily cashflow needs and balancing any deficits on their budgets. The latter is not anymore compatible to the policy of Government in view of the principle of cost-reflective electricity prices.

The financial needs of LAs and RCs to provide non-profitable services cannot be ignored and therefore the LA Surcharge on electricity cannot be removed. Hence the ECB developed a methodology for calculating the LA Surcharge over years including extensive consultations with LAs and RCs. However, there remain many LAs and RCs that are in disagreement with the LA Surcharge methodology and hence they are opposed to the establishment of REDs. To address these concerns as well as the overall sustainable income of LAs and RCs a national dialogue is currently taking place, which includes investigations into manners in which the principle of cost-reflectivity, on the one hand, and the sustainability of LAs and RCs, on the other hand, can be accommodated. (More details on the LA Surcharges in a future article).

Another reason for opposition to REDs is that some large LAs view the assistance to struggling LAs and RCs, especially in rural areas, as subsidisation. Even if this is true, the subsidisation will be minimal due to the small size of the electricity industry in rural areas. Also, this is ultimately in the interest of the whole industry and in line with Vision 2030. The refusal to accommodate struggling LAs and RCs is in conflict of Government policy to uplift the socio-economic standards in rural areas.

Article 2 next week will cover the history of REDs and how it became a policy of the Government of the Republic of Namibia.

<sup>1</sup> A farmer scheme is where a group of commercial farmers establishes a company and, under the name of such company, construct an electricity network on their farms. Such company then distributes electricity in the area of the farmers who joined the scheme.

<sup>2</sup> There are various mines in Namibia, which distribute electricity to the towns/settlements of people who work on and around the mine. Examples are: Ongopolo in Tsumeb and Kombat, Rosh Pinah, Namdeb, etc.

<sup>3</sup> The ideal entity recommended by the Restructuring Study completed in 1998 is the private sector company. Thus all REDs in Namibia are established as private (i.e. not listed on any stock exchange like a public company) companies (i.e. a (Pty) Ltd) under the Companies Act, 1973.

<sup>4</sup> To date no farmer scheme or mine has joined a RED and thus all existing REDs are owned by public entities. The reason for the latter not joining is not due to unwillingness but solely because it is a timeous process and, if the scheme or mine, does not want to become a shareholder of the RED, the RED will eventually have to buy out the scheme or the mine's electricity business. Currently REDs do not have the finances to do so.

<sup>5</sup> kWh is the unit of measuring electricity consumption, commonly known as just a "unit".

<sup>6</sup> LA Surcharge is an additional charge by LAs on electricity prices to subsidise other non-profitable services e.g. roads, streetlights, parks, etc.

<sup>7</sup> The LA Surcharge adds a considerable financial burden to the REDs and on the electricity customers in a LA. In fact, the

surcharge results in most REDs being able to only show profit / break even five years after their establishment.

<sup>8</sup> Nored was the first RED to declare a dividend in 2006 of N\$ 2 million for distribution amongst its shareholders. Such dividends are paid to the LAs and RCs in addition to the surcharges they receive monthly.