



## **Annexure A**

### **NATIONAL FREE BASIC ELECTRICITY (NFBE) RATE METHODOLOGY**

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## **ABBREVIATIONS**

<b>FBE</b>	Free Basic Electricity
<b>NFBE</b>	National Free Basic Electricity
<b>EBSST</b>	Electricity Basic Services Support Tariff
<b>DMRE</b>	Department of Mineral Resources and Energy
<b>FBS</b>	Free Basic Services
<b>NERSA</b>	National Energy Regulator of South Africa
<b>IBT</b>	Inclining Block Tariff
<b>CPI</b>	Consumer Price Index
<b>KWh</b>	Kilowatt-hour
<b>ERA</b>	Electricity Regulation Act

## DEFINITIONS

- Free Basic Electricity: Limited free amount of electricity supply deemed necessary to support the basic energy services of a typical poor household as determined by Government from time to time:  
*(FBE Policy: 2003.)*
- Household: Residential premises with an official point of supply.  
*(FBE Policy: 2003.)*
- Free electricity: Electricity supply at no cost.  
*(FBE Policy: 2003.)*
- NFBE rate: The rate at which Eskom is reimbursed by municipalities for providing FBE units to qualifying customers.

## **EXECUTIVE SUMMARY**

- a) Municipalities have the constitutional responsibility to provide basic services, and the equitable share allocation enables them to do so. In areas where Eskom is the supplier, the FBE is provided on behalf of municipality by Eskom. In such areas, the municipality enters into an agreement with Eskom which covers households that are in the Eskom supply areas within the municipality.
- b) The National Energy Regulator of South Africa (NERSA) developed a methodology to determine the National Free Basic Electricity (NFBE) rate. The tool is used annually to determine the NFBE rate that Eskom charges the municipalities for supplying FBE on its behalf. The methodology was approved in May 2011, and reviewed in 2013 and 2017.
- c) The purpose of the review is to enhance FBE regulation. Certain sections of the mechanism have been revised to align objectives and ensure that the process of determining the FBE rate is fair and transparent.
- d) One lesson learned through the previous methodology was that some of the sections were not clear on their intended objectives, particularly on when volume forecasts made by Eskom are not met.

## 1. INTRODUCTION

- 1.1. The National Free Basic Electricity Rate Methodology is developed for the determination of the NFBE rate that Eskom charges the municipalities to supply Free Basic Electricity (FBE) to households in the Eskom supply areas within the municipal boundaries. The Department of Mineral and Energy (DME) introduced the Electricity Basic Services Support Tariff (EBSST) Policy in 2003, which makes provision for 50kWh per month of electricity to indigent households identified by municipalities and connected to the national grid. In support of this policy statement, the National Energy Regulator (NER) approved the first NFBE rate on 20 September 2003.
- 1.2. The FBE funding is provided by the National Treasury to local authorities through equitable share allocation as identified by the Department of Cooperative Governance and Traditional Affairs (CoGTA). The Local Government Equitable Share refers to the funds that flow from the National Government and are equitably distributed to local authorities to supplement their internally generated revenues and provide basic services to poor households. In areas where Eskom is the supplier, Eskom provides the FBE on behalf of the municipality. In such areas, the municipality enters into an agreement with Eskom, which covers households that are in the Eskom supply areas within the municipality. Each month, Eskom bills the municipality for the FBE allocations that it provided to customers. The NFBE rate is the rate at which Eskom is reimbursed by municipalities for providing FBE units to qualifying customers on their behalf.
- 1.3. Eskom appoints principal agents to roll out the FBE units to sub-agents, and finally to consumers. Each principal agent enters into a fixed contract with Eskom, which contains conditions for providing the service and payment. The contract stipulates, among others, a fixed vending commission, and is payable to the principal agent by Eskom over the term of the contract. The vending commission is a rate that the vendors (principal agents) charge Eskom for Administer the FBE on its behalf.
- 1.4. NERSA annually reviews the NFBE rate that Eskom charges the municipalities for supplying FBE to qualifying households that are in the Eskom supply areas within the municipal boundaries. In accordance with section 16(2) of the ERA, a licensee may not charge a customer any tariff other than that determined or approved by the Energy Regulator as part of its licensing conditions. It is for this reason that NERSA determines the NFBE rate that Eskom charges to municipalities for supplying FBE on their behalf.
- 1.5. NERSA does not have the mandate regarding the FBE Policy, but does implement the DME EBSST Policy introduced in 2003 as required by section 4(a)(iv) of the *Electricity Regulation Act, 2006 (Act No. 4 of 2006)*. The NFBE rate is adjusted annually using a methodology that was reviewed and approved by the Energy Regulator.

## **2. LEGAL BASIS**

Section 16(2) of the Electricity Regulation Act, 2006 (Act No. 4 of 2006) ('the ERA') stipulates that 'A licensee may not charge a customer any other tariff other than that determined or approved by the Regulator as part of its licensing conditions'. In support of government policy initiatives, and in line with section 16(2) of the ERA, NERSA has developed a procedure manual and determines the NFBE rate that Eskom charges to municipalities for Administer the FBE on its behalf.

## **3. PROPOSED MITIGATION TO CURB THE HIGH FORECASTED FBE VOLUMES**

- a) The forecasted FBE volumes supplied by Eskom should be based on the historical data. e.g. Total number of qualifying customers who collected their FBE allocation for previous financial year as supplied by municipalities.
- b) The customer collection rate must be supplied per Municipality
- c) Eskom's forecasted FBE volumes must reflect the current conditions of the market at the time of the application, such as the total number of customers that collected FBE tokens in the previous financial year (one-year leg).
- d) It is impossible to be 100% correct when forecasting. Should there be a difference between the actual and forecast FBE volume, the difference will be subject to the NFBE clawback/payback mechanism. This states that the difference should either be clawed back to Eskom (if actual is higher than forecast) or be given back to the customers (if actual is less than forecast).
- e) The forecasted FBE volumes should be limited to 2% or less than the previous year (one-year leg) actual volumes. This is based on the past 3 years' data where Eskom forecasted more by 4%, 8% and 12% respectively.
- f) The clawback/payback mechanism will apply should the difference between actual and forecasted volumes be above 2% when compared with previous years' (one-year leg) audited volumes.
- g) The clawback/payback mechanism is to allow for changes in the actual conditions for specifically the identified number of customers or forecast sales when compared to the assumptions made when the NFBE rate was considered.
- h) In order to verify the sales forecast, Eskom must furnish the Energy Regulator with total number of qualifying customers who collected their FBE allocation per Municipality for previous financial year.

- i) NERSA will request the number of customers configured, total number of approved customers to receive the FBE, and the total number of customers who collected their FBE allocation from the municipalities to verify the information supplied by Eskom.
- j) NERSA shall review and adjust the information submitted by Eskom before the determination of the NFBE rate annually.
- k) The implementation date for the NFBE rate is 1 July annually.

#### 4. NFBE RATE MECHANISM

- a) NERSA developed a methodology to determine the NFBE rate.
  - i. This tool is used annually to determine the NFBE rate that Eskom charges the Municipalities for supplying FBE on its behalf.
  - ii. The following revised formula must be used to determine the NFBE rate:

$$NFBE \text{ rate (c/kWh)} = (Total \text{ Energy cost (R)} + Total \text{ vending commission (R)} \pm Claw \text{ back/Payback (R)}) / Forecast \text{ FBE volumes (kWh)}$$

**Where:**

- Total Energy cost (R) = Annual total FBE consumption (kWh) x Eskom IBT 1st block rate for that particular year
  - Total vending commission cost(R) = Annual FBE consumption (kWh) x total vending commission (R)
  - Clawback/payback (R) = Different between forecast and actual number of customer's x previous year NFBE rate (c/kWh)
  - Forecast FBE volumes(kWh) = forecast total number of customer's x FBE allocated (50/kwh) x12 months
- b) When developing the mechanism, the following attributes were taken into consideration:
    - i. the national number of customers supplied by Eskom as provided by the municipalities;
    - ii. the number of months to supply FBE, i.e.12 months;
    - iii. the amount of the free electricity units of consumption, i.e. 50kWh per month;
    - iv. vending costs for supplying FBE (vending commission costs); and
    - v. the first block of Eskom's approved Inclining Block Tariffs (IBTs) or the cost of the first 50kWh for that particular year. The first IBT's block or the cost of the first 50kWh is used to determine the cost of supplying FBE. The FBE

beneficiaries are only charged from the second block or after 50kWh consumption as the first 50/kWh is for free.

## **5. THE FOLLOWING INFORMATION MUST BE FORMALLY SUBMITTED TO NERSA**

- i. the total number of customers configured, total number of approved customers to receive the FBE, and the total number of customers who collected their FBE allocation by Eskom (1 April to 30 March);
- ii. the above mentioned information will also be submitted by Municipalities for verification
- iii. the forecast FBE volumes/number of customers for the next financial year of that particular year by Eskom;
- iv. the vending commission rate for that particular year as agreed with vendors by Eskom; and
- v. the signed contract agreements between Eskom and the vendors for verification.

## **6. APPROVAL OF THE NFBE RATE**

- a) Eskom and Municipalities submits all required information to NERSA as per the above guidelines.
- b) Failure for Eskom to submit all the required information on time, NERSA will not approve the NFBE rate for that particular year and the previous year rate will be recommended.
- c) Should there be no new contracts between Eskom and the Vendors in place in at the time of approval, NERSA will use the previous year vendors commission when determining the NFBE rate for that particular year.
- d) The information received is then analysed by the responsible Analyst.
- e) Once the analysis has been finalised, the report is prepared and submitted to the Language Editor for editing.
- f) Upon receipt of the report from the Language Editor, the draft document is scrutinised by the Head of Department, then the Executive Manager (EM), followed by the Regulator Member Primarily Responsible for Electricity (FTRM-E) and finally the Chief Executive Officer (CEO).

- g) The submission is then submitted to NERSA's Electricity Subcommittee (ELS) for recommendation to the Energy Regulator for approval.
- h) The process concludes with the Energy Regulator's approval of the NFBE rate for that particular financial year before 30 June.
- i) The Energy Regulator's decision is communicated to the relevant stakeholders [Eskom, the National Treasury, and the Department of Corporate Governance and Traditional Affairs (CoGTA)] before the 1 July implementation date, annually.
- j) Variances between the forecast and actual number of customers shall be assessed and analysed to determine the cause of the variance.

## **7. Review and Modification of the NFBE Methodology**

The Energy Regulator will review the NFBE rate methodology as and when required to ensure that the contents reflect the current regulatory circumstances. The Energy Regulator also recognises that special circumstances may arise that may necessitate changes to be effected to the Methodology. The Energy Regulator will continuously incorporate justifiable changes that are considered necessary to immediately capture clarity, transparency and regulatory efficiency benefits.

## **8. EFFECTIVE DATE**

The effective date of this methodology will be immediate, on approval by the Energy Regulator.

**End.**