



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Private Bag x 115, Pretoria, 0001. Tel: 012 315 5850 Fax: 012 315 5230
Email: MFMA@treasury.gov.za

The Acting Municipal Manager
Matjhabeng Local Municipality
PO Box 708
WELKOM
9460

For attention: Mr. T Tsoaeli

Fax: (057) 357-4393

Dear Sir

RE: MFMA SECTION 33 – COMMENTS ON THE POWER PURCHASE AGREEMENT AND COMMENCEMENT OF CONSTRUCTION OF A SOLAR PLANT

Your letter dated 11 May 2017, received 02 June, requesting our comments on the municipality's intention to appoint a service provider for the development and construction of a solar plant/park and the subsequent conclusion of a power purchase agreement. We also refer to our email communication to the municipality on 07 June 2017 requesting additional information which was received on 15 June 2017.

We have noted the content of the letter including a copy of the power purchase agreement, the document on the procurement process and public consultation undertaken. We have however not received a copy of the newspaper advertisement inviting comments from the local community including an information statement setting out particulars of the transaction. We nevertheless trust that any comments received was considered and responded to amicably.

The main emphasis in section 33 of the MFMA is the extent of the financial obligation which a particular transaction will impose on a municipality over the duration of the contract. Whilst we have noted the motivation regarding the projected savings to be realised, we could not ascertain any financial information regarding this project in terms of the cost of development and construction of the solar plant, including the full financial obligation on the municipality for the duration of the contract. The municipality must also confirm its requirements and the minimum take up arrangements whether or not it is consistent with its needs. This is key information that will allow us and the municipality to fully understand its obligations ensuring compliance with section 33 as this is a long term project that transcends municipal council's term of office. Without such information we are unable to confirm compliance with the provisions of the section.

We have taken cognisance of the fact that this project is a Public Private Partnership. Despite this fact and the council resolution approving the proposed transaction, we could not confirm any report or information which informed council's decision. Therefore our comments are limited to information provided.

**MFMA SECTION 33 – COMMENTS ON THE POWER PURCHASE AGREEMENT AND
COMMENCEMENT OF CONSTRUCTION OF A SOLAR PLANT**

From information provided, we have noted that the proposed solar plant will be constructed in two-phases, and according to the power purchase agreement, each phase will have its own term from the commencement date, which is defined to mean a point in time when the construction of phase one and phase two have been completed and each phase will run for a 20 year period. If our understanding is correct, then the duration of this transaction will be for a period in excess of 20 years. The municipality is required to provide further clarity in this regard, especially as it relates to when procurement for phase two will commence.

We have noted some of the benefits that will flow from this project, including potential for job creation. We also note that the municipality will be awarded 1% equity in the project. We draw the municipality's attention to section 164 of the MFMA which prohibits a municipality from conducting commercial activities otherwise than in the exercise of the powers and functions assigned to it in terms of the Constitution or national and provincial legislation. The municipality must therefore ensure compliance with the above-mentioned section in finalising this transaction. Failure to ensure compliance with this section will result in the municipality incurring irregular expenditure.

We note from the section 41 report submitted by ESKOM, that an amount of over R1.2 billion has been outstanding for over 90 days. We also note that, at the time of reporting, the municipality had not made payment on the April 2017 and May 2017 bulk account. The documents submitted by the municipality mention that the amount owed to ESKOM will be absorbed by this process. However, this is not clear and the municipality has not provided an explanation as to how this will take place. The municipality is therefore required to provide detailed clarity in this regard.

We trust that the municipality has adequate in-house contract management capacity in place to manage a contract of this nature and should it decide to proceed with this project, it will be sustainable.

Therefore, the National Treasury recommends that the municipality satisfy itself that the feasibility study is comprehensive, including to ensure compliance with the Public Administration Management Act read with the Municipal Supply Chain Management Regulations relating to the conducting of business with employees in the state and related matters.

We trust that you will be guided accordingly.

Yours sincerely



Jayce Nair
Acting Accountant-General

Date: 24/7/2017

Cc: MFMA Coordinator: Free State Provincial Treasury

TRANSMISSION VERIFICATION REPORT

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MATJHABENG

Municipality
Umasipala
P O Box 708
Welkom, 9460
South Africa



Mmassepala
Munisipaliteit
Tel: (057) 391 3106
Fax: (057) 357 4393
E-mail: thabiso.tsoaeli@matjhabeng.co.za

OFFICE OF THE MUNICIPAL MANAGER

Enquiries/Navrae/Dipatlisi	:	Mr Thabiso Tsoaeli
Room no/ Kamer nr/ Kamore ya	:	Room 203, 2nd floor
Date/ Datum/Letsatsi	:	28 July 2017

National Treasury (MFMA Division)
16 Floor, 240 Vermuelen Street
Pretoria
0002

BY EMAIL MFMA@treasury.gov.za

Dear Sirs,

MFMA SECTION 33 – COMMENTS ON THE POWER PURCHASE AGREEMENT AND THE COMMENCEMENT OF THE CONSTRUCTION OF A SOLAR PLANT

The above matter, together with your letter dated 24 July 2017, refer.

1. We confirm that we are satisfied with the outcome the feasibility study and have adopted same as our own although it was prepared by Sunelex Energy Proprietary Limited ("**Sunelex**"). This confirmation must serve as an assurance that the feasibility study was duly considered and approved by the Council. In addition, an advert was published pursuant to applicable laws. Further, as you may be aware, the project is a PPP, the aim

of which is to ensure that the municipality has the backing of National Treasury in relation to its obligation to offtake power generated by Sunelex, when the plant becomes operational.

2. It is important to express that there is no advance capital of whatsoever nature put forward by the municipality in relation to this project. It is because of the nature of this project that we have provided you with the financial model that demonstrates our current spending on electricity purchased from Eskom and the financial savings that will be generated should the municipality have Sunelex as its power service provider. It is clear from the financial model that the municipality is presented with an opportunity to purchase power at a much lesser rate, while creating direct employment for approximately 2 000 members of the community during construction.

3. Further, given the importance of the project, we extensively assessed the affordability of the thereof, particularly in so far as it relates to its affordability, and we can confirm that the project is affordable and budgeted for in terms of the strategic objectives of the municipality. In addition, the structure of the project is such that the municipality will be placed in a position to recoup better value from electricity than it is currently the case. For instance, other than creating jobs for the community, dealing with the Eskom debt and owning a plant that is worth over R10 billion as the project is a BOT, the municipality has social economic development obligations that it must fulfil. In this regard, Sunelex has agreed to start a fund to which it will contribute 1% of the net profit generated during the operation of the plant. This fund will be operated by Sunelex as Sunelex will use it to contribute to the social economic development of the community. It is not correct to suggest that the municipality will be a shareholder or equity partner in the project.

4. Accordingly, we have complied with 164 of the MFMA, particular when one considers the fact that the municipality will not be a power generator, but rather a customer of Sunelex, in addition to being a customer of Eskom. Further, we confirm compliance with the

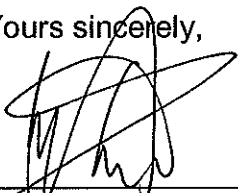
Public Administration Management Act read with the Municipal Supply Chain Management Regulations.

5. Having regard to the above, we request your support with our decision to allow Sunelex to construct the plant on the basis that our budget will be redirected from purchasing power from Eskom to procuring power from Sunelex. Our decision to allow the construction of the plant by Sunelex inherently means that we shall be purchasing power from Sunelex, a natural consequence of changing or adding service providers. Therefore, our request, for your support of this very important project, does not alter any financial position of the municipality, save for the savings demonstrated in the financial model.

For further detail, please refer to Schedule XX attached therein.

We are available to provide further clarity or information. Please do not hesitate to contact us in this regard.

Yours sincerely,

pp: 

MR. THABISO TSOAELI
ACTING MUNICIPAL MANAGER

Schedule XX

MFMA SECTION 33 – COMMENTS ON THE POWER PURCHASE AGREEMENT AND THE COMMENCEMENT OF THE CONSTRUCTION OF A SOLAR PLANT

The above matter, together with your letter dated 24 July 2017, refer.

- 1 In our submissions, made under section 33(1)(a)(ii)(aa) of the Municipal Finance Management Act (the “**Act**”), wherein we solicited your views and recommendations regarding the Power Purchase Agreement and the construction of a solar plant, we requested that you engage with us on any matter pertaining to our submissions that may require further clarification as this would have saved time and resulted in a pertinent response. Based on your response, it is clear to us that further engagements would have been very helpful to both parties. Therefore, in the spirit of a continuous co-operation, we request that you engage us on any issues that may require clarity, before you arrive at any conclusions regarding our submissions.
- 2 Be that as it may, we address this letter to you pursuant to the provisions of section 33(1)(b)(iv) of the Act, confirming that your views and recommendations have in fact been considered. You recommend that we satisfy ourselves regarding the comprehensiveness of the feasibility study, while some parts of your response indicate that you are unable to confirm compliance by the municipality in relation to section 33 of the Act. In this letter, and the attached documents, we provide an explanation and further clarification with regard to the comprehensiveness of the feasibility study and compliance with section 33 of the Act. We further address the issue of business conducted with employees as alluded to in your response.
- 3 With regard to the feasibility study, we confirm that we are satisfied with the outcome thereof and have adopted same as our own although it was prepared by Sunelex Energy Proprietary Limited (“**Sunelex**”). This confirmation must serve as an assurance that the feasibility study meets the expectations envisaged by the Municipal Council when it approved the project. As you may be aware, on 10 December 2014, the municipality approved the construction of the plant on condition that a full feasibility study is carried out, a copy of the relevant resolution is attached hereto as **annex 1**. When the municipality ultimately approved the signing of the Power Purchase Agreement and the lease it was after the completion of the feasibility study, a copy of the relevant resolution is attached hereto as **annex 2**. In this regard, we confirm that a satisfactory feasibility study was undertaken as it formed the basis upon which the project was approved by the Municipal Council, naturally subject to section 33(1) of the Act.

- 4 From a compliance perspective, we limit our response to the matters you have raised in your response. You indicated that you did not receive a copy of the advertisement and the information statement setting out the particulars of the transaction. It is not clear to us how this could have been the case as a copy of the advertisement formed part of our submissions. Be that as it may, please see attached a copy of the advertisement marked as **annex 3**. What is noticeable in your response is that you acknowledge our proof relating to public participation while in the same breath you seem to express your uncertainty that the public may not have received sufficient information about the project.
- 5 In fact, and as you may be aware, this project was declared an emergency economic priority project, as per the attached **annex 4**. This meant that various stakeholders had to be informed of the project and its nuances in order for the project to be realised. This meant that, in addition to information disseminated to the public, stakeholders such as the Department of Trade and Industry, Eskom, the National Energy Regulator of South Africa ("**NERSA**"), the Department of Energy and National Treasury were notified of the project. In this regard, please see attached as **annex 5**, being the letters sent to the aforesaid stakeholders. In fact, the Department of Energy has since instructed NERSA of its allocation of power to Sunelex as per the attached **annex 6** in respect of this project.
- 6 It is also important to note that the project forms an important part of the provincial government's strategy following its announcement by the Premier of the province during the state of the province address, early this year. A copy of the relevant state of the province address is publically available, but we are happy to provide you with same should you deem it essential. The aforesaid, gives credence to the openness regarding the project, in so far as it relates to public awareness. In addition, to date, no adverse comments have been received from the members of the public or the private sector in respect of this project.
- 7 In the third paragraph of your letter you stated that it is unclear to you what financial obligations the project will impose on the municipality. You further stated that it is unclear what the minimum offtake is, and whether or not the required power is consistent with the needs of the municipality. These two factors appear to have led you to express your uncertainty regarding compliance with the provisions of section 33 of the Act.
- 8 With regard to financial obligations, the development, construction and operation of the project will be fully funded by the Sunelex, its funders and equity partners. This means that there are

no financial obligations on the municipality whatsoever with regard to the development, construction, operation of the project. The only obligation that will arise will only be limited to the power sold by Sunelex to the municipality in terms of the Power Purchase Agreement when the plant becomes operational.

- 9 You noted correctly that the project is a PPP project. As you may be aware, the aim of the PPP process, as it relates to this project, is to ensure that the municipality has the backing of National Treasury in relation to its obligation to offtake power generated by Sunelex, when the plant becomes operational. There is no advance capital of whatsoever nature put forward by the municipality in relation to this project. It is because of the nature of this project that we have provided you with the financial model that demonstrates our current spending on electricity purchased from Eskom and the financial savings that will be generated should the municipality have Sunelex as its power service provider. It is clear from the financial model that the municipality is presented with an opportunity to purchase power at a much lesser rate while creating direct employment for approximately 2 000 members of the community during construction.
- 10 With regard to minimum offtake and whether or not the required power is consistent with the needs of the municipality, in terms of the Power Purchase Agreement, a copy of which was submitted to you and is also available on request, it is clear that the municipality is not obligated to purchase more power than it requires. In terms of the D-Form, a copy of which was submitted to you and is also available on request, it is clear that the municipality consumes, approximately 170MW of power. Therefore, both the Power Purchase Agreement and the D-Form set out the minimum offtake, and demonstrates that the power required is consistent with the needs of the municipality. The fact that the Power Purchase Agreement is for a period of 20 years offers further credence to the conclusion that the municipality requires power that will meet its needs on a consistent basis.
- 11 The issue of the duration of the municipality's obligation to purchase power for a period of 20 years is somewhat misunderstood by National Treasury. It is correct that the Power Purchase Agreement is for the duration of 20 years. However, in light of the fact that the -
 - 11.1 project will be constructed in 2 phases, namely phase 1 and phase 2;
 - 11.2 plant will be transferred to the municipality at the end of the 20 year period, as the project is a Buy Operate and Transfer,

it makes sense that each phase will run for 20 years. The effect of this is that the municipality will own phase 1 before it owns phase 2 of the plant. The time period between the time the municipality will own phase 1 and 2 will depend on the date on which phase 2 became operational.

- 12 A further misunderstanding which could easily have been resolved, appears at paragraph 6 of your letter, which relates to the 1% equity. Other than creating jobs for the community, dealing with the Eskom debt and owning a plant that is worth over R10 billion, the municipality has social economic development obligations that it must fulfil. In this regard, Sunelex has agreed to start a fund to which it will contribute 1% of the net profit generated during the operation of the plant. This fund will be operated by Sunelex as Sunelex will use it to contribute to the social economic development of the community. It is not correct to suggest that the municipality will be a shareholder or equity partner in the project. In fact, National Treasury is assured of the municipality's awareness of section 164 of the Act.
- 13 On the issue of the debt owing by the municipality to Eskom of R1.2 billion, it is incorrect to understate that the amount owing is over a period of 90 days. This debt has been growing over a number of years due primarily to the interest that has accrued and numerous penalties imposed by Eskom over those years. Sourcing an alternative supplier of power is a rational and prudent act, otherwise this debt will never decrease. In fact, it will continue to increase. Sunelex has provided us a solution to procure power at a very low cost, and the savings generated could assist us in settling part of the debt owing to Eskom. Ultimately, when we own the plant, we will be placed in a much better position than we currently find ourselves.
- 14 Finally, the issue of having adequate in-house contract management capacity to manage a contract of this nature should not have formed part of your response, as it cannot be assumed that such capacity is lacking on the part of the municipality. It should have been apparent to National Treasury that this is a contract to purchase power from an energy generator, a scenario which does not differ from our current position with Eskom, from a contract management perspective.
- 15 In addition, it is unclear, from our point of view, the reasons that National Treasury felt it necessary to bring our attention to the provisions of the Public Administration Management Act read with the Municipal Supply Chain Management Regulations. Be that as it may, we confirm our awareness of the aforesaid law.

- 16 Having regard to the above, and pursuant to section 33(1)(b)(iv) of the Act, we confirm that the views and recommendations of National Treasury have been considered by the Municipal Council. Accordingly, we request your support with our decision to allow Sunelex to construct the plant on the basis that our budget will be redirected from purchasing power from Eskom to procuring power from Sunelex. Our decision to allow the construction of the plant by Sunelex inherently means that we shall be purchasing power from Sunelex, a natural consequence of changing or adding service providers. Therefore, our request, for your support of this very important project, does not alter any financial position of the municipality, save for the savings demonstrated in the financial model.
