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**ENERGY**/Anton Eberhard

# On the private road back to power supply security

IT IS now inevitable that the private sector will have an expanded role in restoring electricity supply security in SA. This may seem a surprising assertion, given Public Enterprises Minister Alec Erwin's recommitment in Parliament last week to the "vanguard role of state-owned enterprises (SOEs) in powering a developmental state".

Yet serious initiatives to secure increased private investment in electricity generation have already begun. Eskom is running three separate processes to contract private power.

Erwin does not, of course, rule out private participation. He talks of the advantages of SOEs accessing private capital markets and also of entering into partnerships with local and global companies that can provide access to new strategic technologies. Yet he remains deeply committed to building a developmental portfolio of SOEs in areas such as network infrastructure (electricity, freight transport and broadband) in order to pursue public and strategic objectives.

Eskom remains one of the government's foremost champions in achieving this vision. Yet, as Allister Sparks argued on these pages a few weeks ago, Eskom's failure to keep the lights on reveals the limits of the developmental state. Eskom used to be regarded as SA's premier SOE. Since 1994, Eskom has provided electricity to more than 3,5-million new households. In 2001, the Financial Times of London named Eskom "Power Company of the Year". In 2004, it received the Markinor Sunday Times award for SA's "most admired brand". Such awards are now inconceivable.

Yet many within the African National Congress and the government still hold a deep antipathy to the role of the private sector in infrastructure. In part this stems from an old ideological stance around the role of the state. But it is also informed by unfortunate experiences with private sector participation. The strategic equity sale of part of Telkom resulted in neither improved services nor lower costs. This was not surprising given the fact that the government did little to mitigate the market power of this new private monopolist. Yet the enduring memory of many in government is that we were screwed by the private sector.

Some government ministers still believe that the power crisis is a result of the private sector not investing in 2001-04, when a competitive market was being designed. A more recent example is the collapse of negotiations with a private investor to build 1 000MW of peaking plant. In December 2003, the cabinet mandated the minerals and energy department to run a competitive tender for independent power producers (IPPs). Five years later, the process is in disarray, in part because the preferred bidder demanded changes that were so far from the original tender that even the project's senior lenders walked away because of the risk of legal challenges to the legitimacy of the process.

> 'We shall be able to provide reliable and competitively priced electricity only to the extent that the government learns to contract the private sector effectively.'


Picture: BLOOMBERG

But the ultimate lesson from these examples is not the futility of private sector investment in infrastructure — too many successful international examples could be cited. Rather, it is the importance of state institutions learning how to contract the private sector more effectively. The department's IPP bid process was excruciatingly slow and complex. Thousands of pages of clarifications were issued along the way to bidders. Key issues remained unresolved for long periods. No reserve bidder was retained. It is sobering to note that even if the department had reached financial closure, the plant would only have come on line in 2010, seven years after the process started. A similar tender in Jordan, also for an open-cycle gas-turbine plant, commenced later and the same bidder, AES, is already producing power. Across Africa, there are more than 40 IPPs, many of them in countries with investment climates much more challenging than ours.

Prior to the recent tender, there was no way for the private sector to enter the South African power market. The government had abandoned plans for a power exchange where private generators could sell electricity and there was no contracting framework for IPPs. With Eskom's average electricity price less than half the price of new power, no consumer would contract directly with IPPs. The only way for IPPs to enter the market would be to sign a long-term power purchase agreement with Eskom who would then average out prices for consumers.

And that is what will now happen, not because of any ideological shift, but rather because there is no alternative. Eskom is quietly getting on with the process of contracting private generators. It is doing so because it understands that even if it restores its coal stockpiles and gets its existing generators to operate more reliably, and even if the price of electricity rises to more economic levels and consumers save electricity, and even if its own investment programme in new generation capacity delivers on schedule, we will still be short of power over the next five to seven years. As one Eskom executive put it, Eskom's "big coal, big nuclear and big networks" investment strategy will take time to materialise; multibillion-rand base-load power plants take years to plan and build.

In the meantime, the private sector can potentially offer smaller, more flexible and quicker solutions in the form of IPPs and industrial co-generation plants (using waste combustible materials and heat to also generate electricity, which can be fed back into the grid).

Crucial to the success of these programmes will be a robust, transparent and fair contracting framework. Eskom staff are starting to learn valuable lessons in negotiating with potential private suppliers. They have also engaged experienced international legal and financial transaction advisers. It will be critical that contracts are as clear and as simple as possible so certainty is provided and investment decisions are made as soon as possible. It is encouraging that, in its medium-term power purchase programme, Eskom appears to have revealed its avoided cost and has indicated it is willing to contract at prices of between 65c/kWh and 105c/kWh between 2009 and 2013, falling progressively from 2014 to an eventual level of 35c/kWh in 2018. These prices are very much higher than its current sub-economic tariffs.

But the current procedures for contracting the private sector also create potential contradictions. In effect, Eskom will be acting as a single-buyer of power produced by IPPs, while at the same time also investing in its own generation plant. Ideally the planning, contracting, system operation and transmission functions of Eskom should be in a separate and independent institution, but major restructuring will be unwise and is unlikely in the midst of a power crisis. Nevertheless, careful thought should be given to an institutional design and governance mechanism that gives the regulator, investors and consumers confidence that Eskom is procuring and contracting transparently and fairly.

Even if state-owned utilities such as Eskom (and also Transnet and Infraco) remain strategic instruments to realise government policies, their difficulties in delivering reliable and appropriately priced infrastructure services reveal the limits of the developmental state and hence the imperative to also facilitate private sector participation. Therein lies the core challenge for the government. We shall be able to provide reliable and competitively priced electricity (and transport and telecommunications) only to the extent that the government learns to contract the private sector effectively, or introduces private competition where that is possible.

■ *Eberhard is a professor at UCT's Graduate School of Business. This is the final article in a series assessing progress towards restoring power supply security.*