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Conflict of interest at Eskom stymies SA's power supply

25 Feb 2014 | Anton Eberhard

Eskom is the dominant player in the electricity sector and has no incentive to initiate or conclude contracts with independent producers, writes Anton Eberhard

ANOTHER failed attempt to restructure Eskom will make it more difficult for private investors to build independent power plants (IPPs), and South Africa will face years of constrained electricity supply.

It has become apparent that the proposed Independent System and Market Operator Bill will not be voted on by Parliament anytime soon. The bill sought to remove electricity market functions — such as planning, procurement and contracting of new power — from Eskom and place these under an independent state-owned utility, subject to determinations by the energy minister.

Why is the bill important or relevant? Quite simply, the bill (and proposed amendments to the Electricity Regulation Act) would have created a level playing field between Eskom and IPPs. They sought to remove a real conflict of interest. Eskom is the dominant player in the electricity sector, it builds its own generation plant, and it has no incentive to initiate or conclude contracts with independent producers.

The consequences of this conflict of interest are plain for all to see: Eskom is unable to meet electricity demand reliably or securely. The reasons are not only because it has not built enough new power generation capacity in time but also because it has missed a number of opportunities to contract additional power from IPPs.

The Energy White Paper, published in 1998, predicted that new power sources would be needed by 2007. Indeed, power shortages became apparent from 2006, and in January 2008 Eskom had to shut down our entire mining industry for a week because it ran out of power. The costs to the economy have run into tens of billions of rand. In November last year, Eskom again declared force majeure and forced large electricity customers to curtail demand by 10%. Economic growth is being constrained because of inadequate electricity supplies.

Power shortages will continue for the next three or four years until enough new units of the new coal megaplants, Medupi and Kusile, are commissioned. But we need not have been in this situation. If Eskom had signed power deals with IPPs, South Africa would now have sufficient energy to support new investment and accelerated economic growth.

For example, developers of the 800MW Kudu gas-to-power project in Namibia have tried on a number of occasions to get Eskom to commit to a long-term contract, but the national utility argued that the prices offered were too high and that it could build power stations more cheaply.

In 2009, the Canadian-financed Mmamabula coal project in Botswana of 1,200MW offered Eskom a rand-denominated long-term contract for 72c/kWh, with below-inflation escalation clauses. About $100m of private risk equity had been spent developing the project. Everything was ready. A Chinese engineering contractor had been signed. Finance was in place. If Eskom had signed a power purchase agreement, the project would now be delivering power. But, once again, Eskom argued it could do better. We now know that Medupi and Kusile will cost very much more than either Kudu or Mmamabula.

Eskom has also failed to conclude any of its own IPP procurement initiatives within South Africa. In 2007, it launched a Pilot National Co-generation Programme and issued an expression of interest, which subsequently elicited 125 qualifying bids totalling 4,900MW. None was contracted.

In 2008, Eskom initiated the Medium Term Power Purchase Programme for projects that could supply a total of 3,000MW of electricity to the grid by 2012. However, decisions on preferred bidders were delayed repeatedly, and by 2011 only 373MW had been contracted.

Eskom also called for an expression of interest in April 2008 for potential base-load projects, to which 76 companies responded. The utility then issued a request for qualification in August 2008 in terms of which 23 local and international developers prequalified. However, by 2009, the base-load programme, along with the Pilot National Co-generation Programme and Medium Term Power Purchase Programme, had all been suspended by Eskom.

Some have described Eskom’s actions as malicious compliance. It has accepted that it is government policy to introduce IPPs. Eskom has gone through the motions, but in each case the initiatives have yielded nothing. Others have suggested that it is unfair to blame Eskom managers, who are beholden to the political directions of its shareholder, the Department of Public Enterprises. The real battle, they argue, is who controls big investment decisions.

The Department of Energy’s frustration with Eskom came to a head around plans to procure renewable energy from IPPs. Originally, the plan was to offer a standard feed-in tariff and Eskom was charged with preparing the contract documents. After two years, and no contracted IPPs, the department, with the assistance of the Treasury, launched its own renewable energy IPP programme in 2011. Three rounds of competitive bids have since yielded 64 new projects worth a total of 3,920MW and have mobilised R118bn of private investment.

Given this recent success, some may ask why the operator bill is still important. However, the renewable energy IPP programme is being managed by more than 100 private consultants under the supervision of less than a handful of key staff at the Department of Energy and the Treasury and is vulnerable to changes in personnel in these departments. What is now needed is to institutionalise, consolidate and strengthen this procurement and contracting capacity in the bill and to extend the procurement programme to base-load IPPs.

The serial failures of Eskom to facilitate private investment in power, its inability to meet electricity demand and, by contrast, the success of the renewable energy IPP programme, appear to make the argument for establishing a neutral, independent institution to procure and contract IPPs obvious.

That makes the shenanigans around the bill all the more surprising. President Jacob Zuma, in his state of the nation address in 2010, committed the government to establish the bill. The National Planning Commission came out in support of the bill. The draft bill was approved by the Cabinet and was passed by Parliament's energy committee in March last year. It was due for debate in the National Assembly on June 12, but at the last moment was withdrawn and, without any published reasons, sent back to the committee, which approved it a second time on November 8.

It was due to be debated on the last day of Parliament last year, but on the morning of the debate was moved below the line, in effect meaning it could not be debated and has thus lapsed. The bill can now be resuscitated only if it is reintroduced by the minister.

All this detail may seem a little arcane — but it demonstrates the trench-like warfare by vested interests against the bill.

The issues are now clear: will Eskom be allowed to maintain its monopoly, including being able to frustrate the entry of IPPs, or will the government create a professional and independent electricity market operator that will procure and contract new power at competitive prices?

It is not hard to see which option is in the national interest. Electricity consumers will watch this space carefully.

• *Eberhard is a professor at the University of Cape Town's Graduate School of Business and a member of the National Planning Commission.*

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