ANTON EBERHARD: Competition is the balm to heal Eskom

Opening the industry up to independent producers after a process of unbundling is a way to solve power SA's crisis

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The debate over whether it makes sense to restructure SA's national power utility is in effect over. In a special paper released this week, the government has outlined a road map for Eskom in a reformed electricity supply industry.

Eskom will cease to exist in its current form. Electricity transmission, system operation and market functions will be transferred to a separate company. Competition in power generation will be encouraged. At a later stage, the division currently responsible for electricity distribution and customer sales will also be moved to a separate entity.

The first milestones have been set: by March 2020 a transitional board for the transmission entity needs to be in place and functional unbundling completed. Legal separation will be completed in 2021.

This proposal is not trivial: SA often struggles to translate policy ambitions into implementation; now we'll have an institution incentivised to drive the migration of people, system, assets and debt into this new entity and make the first restructuring step a reality; it will be visible and it will create inexorable momentum for reform.

These restructuring proposals were first made in the 1998 white paper on energy policy, but were never implemented. Eskom was not in crisis then and was subsequently ordered to build two mega coal power stations — Medupi and Kusile — which ended up being nearly three times over budget and more than seven years late, resulting in huge debt and the utility's insolvency.

Eskom generates less than half the cash it needs to service the principal and interest on its debt. Each year it sells less electricity and the only way to increase revenues has been to hike tariffs, which have increased fourfold, in real terms, since 2006. And the more tariffs go up, the more consumers invest in energy efficiency, use less electricity or defect from the grid.

Eskom is now in a classic utility death spiral. Business as usual is no longer an option. Restructuring and the development of new business models are essential for a more sustainable future.

Eskom restructuring has two broad rationales and potential sets of benefits. First, boards and managers can focus, laser-like, on the three very different elements of Eskom's value chain.

Distribution is a customer-facing business; it requires a different set of capabilities to power generation, which for now is mostly about keeping old kit operational and, in future, being efficient in the face of fierce competition. Transmission, system and market operations are about procuring and purchasing competitively priced, reliable power; balancing supply and demand; and delivering electricity to the main load centres. Dedicated and differentiated skill sets are necessary to reduce costs and improve efficiencies in each of these businesses.

When these functions are all in one company it is easy for the board and management to be consumed by crises in specific areas of the business — as Eskom is currently regarding the problems with its coal power stations — and to neglect the rest of the divisions, to the detriment of consumers and the nation. Eskom has been diverting capital and maintenance budgets away from transmission and distribution to its problematic generation business, thus threatening the future reliability of the grid.

If these functions are separated there will also be more transparency regarding costs and it will be easier for the regulator to establish prudent expenditure and to determine cost-reflective tariffs.

There is a second set of benefits that arise from restructuring, namely those that derive from the introduction of competition. Most countries now recognise that there is no intrinsic logic in keeping power generation, transmission and distribution integrated in a single monopolistic utility. While the wires components — transmission and distribution — are mostly natural monopolies, power generation is potentially competitive; multiple companies can invest, build and operate power stations and compete to sell electricity either to the national transmission system or market operator, or directly to customers.

Globally, 106 countries have now unbundled their national utilities; SA is finally catching up. As President Cyril Ramaphosa memorably noted: “Currently, all our energy eggs are in Eskom’s basket; when they fall, the economy breaks ... we need more diversity and resilience.”

While government is to be applauded for its commitment to push through the restructuring of Eskom, opposition from some stakeholders, such as organised labour and rent-seekers who benefit from contracts with the national utility, will not easily or quickly melt away.

One of the lessons of the failed attempt to restructure Eskom in 1998 is to better understand the political economy around Eskom and engage more effectively with different stakeholders, their material and political interests, their access to formal or informal institutions and networks or *de jure* and *de facto* power, and the way they use ideology and knowledge to delegitimise or legitimise reforms or the status quo.

The public enterprises ministry has its hands full trying to keep SA’s major state-owned infrastructure companies afloat. It does not have space or time to manage a dedicated and consistent engagement process with labour unions around Eskom restructuring; nor does the Eskom board or its senior executives, who are desperately trying to keep the lights on. This is another reason we need institutional, governance and technical support for driving and managing the restructuring process.

Splitting Eskom into three separate entities is not a sufficient step for fixing Eskom or for securing SA’s electricity supplies at competitive prices, but it is a necessary step to a more sustainable future.

Government forges ahead with Eskom split

The Eskom road map outlines a range of other required interventions such as strengthening the Eskom board, appointing a CEO who can provide new leadership, building capabilities across the organisation, improving the performance and availability of Eskom power stations, compressing costs, reversing the payment arrears of municipalities, and directing the regulator to approve more sustainable tariffs.

The government still has to decide the quantum and mechanism for Eskom debt relief and refinancing. The finance minister appears to be withholding details until seriousness about structural reforms is demonstrated. The government also has to decide whether it will explore the feasibility of reducing the cost of Eskom’s capital through a blended climate-linked finance facility in return for a commitment to accelerate the decommissioning of Eskom’s old, expensive coal power stations. This fund could also provide support for just transition investments to mitigate impacts in coal towns and communities.

The previous attempts to restructure Eskom were halted when the government panicked over the risks of power shortages and the urgent need for new investment. We face a similar challenge now. The difference is that there are now competitive alternatives to Eskom in the form of independent power producers (IPPs) and self-generation.

The proposals to restructure and reform SA’s power sector will be successful not only if there are institutions and programmes that engage stakeholders and manage the process effectively, but also if the government moves with urgency to procure new IPPs and free the market for a multitude of entrepreneurs and consumers to invest in small distributed power systems.

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