SA’s power lies in breaking up Eskom’s monopoly model

21 Jul 2016 | Anton Eberhard

SA needs a separate state-owned electricity market and transmission operator, writes Anton Eberhard

THE chairman of Eskom’s board has written to the energy minister, stating that Eskom will not sign any further power purchase agreements with independent power producers (IPPs) after the current round of renewable energy projects are concluded. The potential consequences could be devastating for private investment in SA’s power sector, and could terminate the government’s most successful public-private procurement programme.

In the past five years, the Department of Energy has procured 92 privately funded power projects totalling R193bn. No other government-initiated programme rivals the scale of investment achieved, or the degree of transparency.

Despite intense competition — there were almost 400 bids over multiple tender rounds — there have been no legal challenges or accusations of impropriety or corruption. The programme has also resulted in economic development benefits in domestic manufacture, job creation, ownership and community development.

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Eskom argues, misleadingly, that IPPs are too expensive. It quotes first-generation IPP costs and ignores the extraordinary fall in contracted renewable energy prices — more than 70% for solar photovoltaics and almost 50% for wind energy.

The latest IPPs, including bids for coal-powered projects, are now cheaper than Eskom’s average cost of supply and about half the cost of its new power stations. And unlike Eskom tariff hikes, contracted IPP prices in the future cannot increase by more than the rate of inflation.

Eskom’s opposition to competitive IPPs is not unexpected: that is what dominant incumbent utilities do. But clearly it is not in the public interest when the costs of Eskom’s new power stations have doubled and their completion has been delayed by many years. We forget too easily that these delays resulted in power cuts and a curtailment of economic growth.

Public utilities often argue they can deliver power at a lower cost than private investors. They have access to lower-cost capital, don’t they? Eskom’s precipitous credit rating decline from investment grade to junk status undermines that claim. And its inefficient deployment of capital has resulted in extra costs being passed on to customers through higher tariffs.

The IPP investment model is exactly the opposite. Private investors take the risk of cost overruns and consumers are protected by fixed-price, long-term supply contracts.

We should protect and accelerate the advances that have been made in opening parallel spaces for private investment in power-generation in SA. This requires regulatory and institutional reforms.

For now, IPPs have been procured by an IPP office that operates outside the department. That procurement function needs to be embedded in a secure institution linked to the heart of the electricity industry — namely the system and transmission operator that balances supply and demand, and connects power generators to distributors and customers.

What we need now is a separate state-owned electricity market and transmission operator that takes care of electricity planning, power procurement and contracting, system operation and balancing, and transmission. Let's call it Gridco. This obviously needs to be independent of Eskom generation and IPPs, so it can procure power at the least cost.

That implies separating Gridco from Eskom's generation business (let's call it Genco) to remove the kinds of conflicts of interest we are now experiencing in which Eskom frustrates the entry of IPPs and private investment through disingenuous use of facts, political brinkmanship and what lawyers term malicious compliance, through the quiet subversion of government policy by actions such as delayed access or inflated grid-connection costs for IPPs.

Breaking up Eskom may seem like a radical restructuring proposal. It is not. It was proposed in the Energy Policy White Paper in 1998.

And it's logical. It separates the potentially competitive elements of the electricity industry — power generation — from the natural monopoly component, transmission. It's also potentially efficient as it creates focused utilities — Genco and Gridco — in two very different kinds of businesses. And it's easily achievable, as evidenced in more that 90 countries around the world.

The first step in this restructuring path is an accounting separation between Eskom's generation and transmission divisions.

The energy regulator, Nersa, already requires this. The next step would be to create separate Eskom Genco and Gridco subsidiaries, again relatively easily achievable within the existing Eskom Holdings company structure. And the logical further step would be to create Genco as a separate state-owned company.

The difficulty in restructuring state-owned utilities is that when they are in crisis, governments are careful not to propose interventions that might further destabilise them. But when the crisis recedes, so does the political imperative for restructuring. When Eskom was load-shedding, the focus was on immediate measures to keep the lights on and on improving its financial viability. It was more difficult to agree on far-reaching reforms that might prevent similar crises occurring in the future.

The restructuring of state-owned enterprises requires vision, leadership and commitment to remove impediments to investment and achieve efficiency improvements that facilitate economic growth. Within the existing contested political terrain, that might be a big ask. But surely individuals and institutions can rise to that challenge?

Instead of Eskom's leadership defending an old, vertically integrated, monopolistic electricity industry model that international experience shows is moribund, would they not want their legacy to be distinguished by a reforming zeal that sets our country on a different path?

This is not a pipe dream. Until recently, SA had no IPPs. But in the past four years, we have attracted more private investment in power than the rest of sub-Saharan Africa has in the past 25 years. We are ranked by Bloomberg New Energy Finance among the top 10 countries globally.

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The renewable energy IPP programme is being extended to industrial cogeneration, coal and gas power projects. There are huge opportunities for the advancement of black-owned power companies and the development of local competencies.

It is not naïve to believe SA's electricity sector can, and will, be restructured. I've seen it happen in many countries. Perhaps, SA's fiscal position will have to deteriorate further before we accept we can no longer fully fund our public utilities — we've pumped R83bn into Eskom since 2008 — and that a greater openness to private investment is inevitable. It would be better to start that reform process now, before we are once again in crisis.

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