Privatisation of Australian electricity supplies leads to shortages and blackouts

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Widespread electricity rationing in the state of Victoria last month—which cut supply to thousands of households and businesses in the middle of a heat wave—was not an unavoidable or unforeseeable development. It was symptomatic of what has prevailed in the power industry nationally since it was either corporatised or privatised, allowing market forces to dominate.

In February, Victorian Labor Premier Steve Bracks faced an outcry when it was revealed that while electricity was cut off to homes, the private power companies were profitably selling supplies to neighbouring New South Wales. Those sales were only the tip of the iceberg of the sacrifice of consumers' interests to the profits of the electricity companies.

Bracks attempted to gloss over the underlying causes for the rationing and blackouts by blaming maintenance workers who had been locked out by Yallourn Energy. His government threatened to fine workers $10,000 a day unless they dropped a series of work bans against conditions contained in a new work agreement. Yallourn Energy, one of the privatised remnants of the old State Electricity Commission of Victoria (SECV), provides about 20 percent of the state's energy requirements.

Bracks said: “I don't think anyone could have foreseen that, in addition to an industrial dispute affecting part of the power supply to the Victorian grid, you would also have three generators that would go down at the very time Victoria reached something like 39 to 40 degrees”.

Despite Bracks' claims, the shortages were predictable. Demand for electricity exceeds supply during peak and emergency periods, particularly in heat waves, simply because the private power companies are not willing to invest in maintaining reserve generators. Such investments would be an unacceptable drain on profits because a large amount of capital would lie dormant for most of the year, as a peak or crisis period may last for as little as two days.

Last summer, even if industrial disputation had not closed down power generation at Yallourn Energy, Victoria would still have been within a third of a gigawatt of failing to meet demand. And if Victorian residents continue to buy air conditioners this year at the same rate as last year, the extra demand will not be met next summer.

No new base load capacity has been built in the state since 1992 even though demand for power has grown by 20 percent. And while there are plans to establish an interconnection with the island state of Tasmania on the new national grid, the demand for electricity *in peak periods*, which may be only 40 hours over a year, is growing faster.

The private suppliers have rejected as “gold-plating” the SECV's past practice of maintaining a reserve generating capacity. According to Don Hilton, a former Ecogen Energy executive: “At present a commercial return could not be made by a new investment in a peak generating plant.”

Even after the January-February blackouts, private power companies still talk in terms of eliminating “over-capacity”. Bob Shapard, the chief executive of TXU Australia, which owns the distributor Eastern Energy, said recently: “Electricity prices are now sitting around $25 per megawatt hour, and even when the oversupply is remedied, competition on the national grid would ensure they don't go up a lot from there.”

In other words, for most of the year electricity prices dictate that profit margins for the power companies are very tight. Since electricity, unlike most commodities, cannot be stockpiled, as far as profit making is concerned there is an “overcapacity”. But during a hot spell, this “overcapacity” proves to be a substantial shortfall.

Victoria is the first Australian state where the generation, transmission and distribution of electricity have been entirely privatised. This has already led to far-reaching restructuring and the destruction of thousands of jobs. Since the mid-1990s the number of gigawatt hours generated per employee has risen by 260 percent in Victoria against an average across all states of 65 percent.

Extensive job shedding has taken place in every state as governments increasingly operate power utilities along corporate lines as the prelude to full-privatisation. Already by 1995, Pacific Power in NSW had cut its workforce from a peak of 10,500 to 5,700.

Such cuts have undermined the standard of maintenance. In Queensland for instance, generators at four major power stations failed in early 1998 when the state's electricity supply was stretched beyond its limit during the summer period. In at least five suburbs of Brisbane, the state capital, raw sewage overflowed into creeks and drains as pumping stations and treatment plants were hit by multiple power blackouts.

The corporatisation and privatisation of power was intrinsic to the recommendations of the Hilmer Report, commissioned by the federal Labor government in 1995. All government utilities were required to compete with each other, in a process that prime minister Paul Keating described as one of “never ending reforms”.

The Labor government claimed that “competition” would result in greater efficiency, leading to a reduced price to ordinary consumers. In reality the Hilmer recommendations were designed to cut costs to large businesses and attract global investment. As an *Australian Financial Review* editorial said at the time: “A range of services for consumers, such as electricity and transport, are provided at below market rates. In contrast, business pays more than it should. A pure application of the Hilmer principles would result in these types of distortions being removed... And the best way to win new business ... is to create a business friendly environment.”

Far from cheaper consumer prices and better services, the opposite has been the case. The Electricity Supply Association of Australia showed in 1998 that on average each customer in Victoria suffered power failures 3.96 times a year, while in South Australia, where power was still provided by a government utility, customers experienced failures at the rate of only 1.23 times a year. Victorian power consumers were on average without power for 100 minutes a year more than their South Australian counterparts. Meanwhile Victorian electricity service fees in 1998 were 37 percent higher than those in NSW.

By contrast, business consumers have benefited. The Australian Chamber of Manufacturing in 1998 found that 410 mostly larger companies with access to the new competitive markets in Victoria and NSW had achieved an average 26 percent saving on their power bills, an average saving of $707, 000 and total saving of more than $290 million.

In 1996 the federal and state governments established the National Electricity Market Management Company (NEMMCO) to coordinate a national power grid. Electricity generators now sell their output in a wholesale market covering NSW, Victoria, South Australia and the Australian Capital Territory. Queensland and Tasmania will join later.

Actual interstate transmission is limited. An interconnector with NSW allows Victoria to import 1,750 megawatts, or about 20 percent of its generating capacity. A similar interconnector joins Victoria and South Australia, so that South Australia imports 35 percent of its power.

The integrated market is essentially an arena for trading in supply. Generators such as Yallourn Energy and Pacific Power submit bids to NEMMCO 24 hours in advance for half-hourly periods, based on their assessment of the market.

More than 80 percent of the electricity is sold via contracts with businesses, with the rest, mainly for domestic consumption, traded on the spot market. This makes domestic prices vulnerable to market fluctuations. In late 1997, the Sydney Futures Exchange opened an electricity futures market, allowing suppliers and distributors to contain their financial risks, but also paving the way for speculative trading.

Victoria's privatisations were based on calculations that National Electricity Market prices would range from $35 to $40 per MW hour. Instead, prices have hovered around $22, putting extra pressure on companies to slash costs, or to find ways to pass them on to domestic users.

In order to help sell-off its power industry, the former Victorian Liberal government installed an entire legal framework to shield the new electricity companies against claims for damages and losses.

A key component of these arrangements was a risk management mechanism called *Industrial Relations Force Majeure* (IRFM). Once NEMMCO recognises that an industrial dispute is affecting supply to the electricity pool, IRFM replaces the usual auction system, and the price of electricity is set at between $65 and $110 per kilowatt-hour, about three to five times the average. The price hike then flows on to consumers.

In the major breaks to supply in Victoria in late January and early February an IRFM period applied throughout, effectively protecting Yallourn Energy's profits. Columnist Kenneth Davidson wrote in *The Age* on February 10: “It does not require a conspiracy theorist to see that under the present NEMMCO rules, there is not a strong incentive for power companies to resolve industrial disputes quickly—especially if they have bilateral agreements with other power companies to meet their long term customer contracts in the case of power cuts for whatever reason.”

On the Futures Exchange, the generators (sellers) and distribution companies (buyers) can also “hedge” their transactions—that is, they can enter into contracts that eliminate or reduce the risk of price fluctuations. Yallourn Energy chief executive Mike Johnston admitted that the company had “hedged” to limit its losses during the industrial dispute. It may in fact have made a profit by speculating on the strife.

The IRFM is part of a wider system of *force majeure*, which insures the companies against anything that could stop or limit their ability to operate and earn revenue, including network transmission failure, “Acts of God”, sabotage and vandalism, significant plant or equipment breakdown and failure of external fuel or service supply. These arrangements release distributors from fulfilling contracts, or generators from making compensatory payments to distributors. The cost is passed on, hence increasing the price to the consumers.

As well, clauses in the contracts drawn up with the Kennett government provided for compensation to the generators until the end of 2000 against loss of income resulting from major industrial disputes or changes in government policy. Under another provision called “white hole money,” a levy can be imposed on market customers in Victoria to make up for the higher prices obtained for electricity from NSW during a crisis period. During the Victorian blackouts prices reached $5,000 per MW hour.

The technological advances in electricity generation and the development of a national grid capable of detailed monitoring of electricity flows could provide the basis for an inexpensive and reliable supply of power for every consumer. When these developments are subordinated to corporate profit, however, the opposite is the case—thousands can be deprived of a commodity that is essential for modern life.