Britain’s privatised energy industry on brink of bankruptcy

By Jean Shaoul
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Less than ten years after the privatisation of the electricity industry, the energy market has effectively gone bust. With the growing crisis engulfing ever more companies, power supplies in Britain are now precarious, workers’ jobs and pensions are in jeopardy, and the government faces a hefty bill and a burgeoning political crisis.

British Energy has only been able to trade thanks to emergency loans from the government to give it time to organise a financial rescue and save it from administration.

Powergen, owned by E.ON of Germany, has shut down a quarter of its generating capacity.

UK Coal has halted supplies of coal to AES Drax, its main customer, because of unpaid bills. AES Drax is Britain’s largest power station and the US corporation, AES, now owns it.

On October 14, AES Drax did not receive a £20m payment due from its main customer, TXU Europe, an electricity supplier. With TXU Europe’s American owner withdrawing a promised loan of £450m, the company faces insolvency and its five and a quarter million retail customers face interrupted power supply.

Several energy companies, including AES Drax and TXU Europe, have seen their debt relegated to junk bond status, triggering the early repayment of loans and the cancellation of a number of loss-making power purchases for its retail customers that will precipitate a chain reaction throughout the industry, not just in Britain but the US and Europe.

The crisis in the energy industry follows the collapse and government bailout of the privatised railway infrastructure company, Railtrack, the partially privatised National Air Traffic Services and several other major infrastructure projects under the Labour government’s Private Finance Initiative/Public Private Partnerships policy. In each case, the shareholders and creditors demanded a financial lifeline in the knowledge that the government could not allow essential services to go under. But this ability of private corporations to hold government to ransom has fuelled criticism of the Labour government’s support for the same privatisations it attacked when in opposition and its enthusiastic embrace of new forms of privatising vital public services.

The California energy crisis was due to a lack of generating capacity and generators which could not pass on increased wholesale prices because of regulatory price caps. In contrast Britain’s crisis stems from a surplus that must be taken out if prices are to rise and the corporations returned to profitability. That this crisis has arisen when there is huge over capacity in the electricity industry points to the failure of the much vaunted deregulation, liberalisation and free market competition to ensure either the continuity of supply or the appropriate levels of investment.

Four weeks ago, British Energy (BE), the nuclear power generator that supplies more than 20 percent of Britain’s electricity, collapsed. Its share price fell to 5p, valuing it at just £31m compared with more than £2bn a year ago. Its bond prices also fell. Confronted with the prospect of insolvency and the lights going out all over Britain, the Department of Trade and Industry (DTI) was forced to step in and prop up BE with two emergency loans totalling £650m. This will enable it to continue trading until November 29 and give it time to seek alternative sources of finances.

Angry claims of unfair competition erupted from the other generators. AES, the US owner of AES Drax, is threatening legal action if the government renews its unilateral aid to BE. The Belgian energy minister and British Energy’s competitors, including Powergen, Eastern Electricity, AES and NRG, who also face mounting losses, are demanding an investigation by the European Union (EU) competition commissioner, claiming that the loans are anti-competitive and will give British Energy an unfair advantage. EU rules allow state aid to be given to companies facing collapse only where there is a credible restructuring plan approved by the Commission and where the aid does not give the company a competitive advantage. “There is an issue about credibility because no one really believes that British Energy is a commercially viable firm,” a DTI insider was reported as saying.

Britain’s nuclear power programme has been nothing short of a political conspiracy against the working class from its very inception. Its origins lie in a political decision taken in 1955 to build nuclear power stations that would provide the necessary plutonium for Britain’s nuclear weapons and maintain its military superiority over its weaker European rivals. It would also help close Britain’s yawning energy gap that was hampering British industry’s competitive position. As such, it also served the crucial function of ending reliance on the coal industry and its militant workforce. Crucially it would be funded with taxpayers’ money.

Beset with planning and technical problems, the power stations were massively behind schedule and over budget. This, together with the problems in the reprocessing of the spent fuel (as opposed to storing it) and the decommissioning of the old power stations, meant that the capital expenditure on nuclear power stations, including interest during construction, exceeded £50bn.

Thus—taking into account inflation and the higher value of the pound when compared with the dollar—the collapse of British Energy amounts, as a *Financial Times* commentator put it, to “the biggest write-off in the history of capitalism, dwarfing the $54bn that Time Warner lost on the acquisition of AOL.”

While the industry was always uneconomic, the high costs were deliberately hidden from public scrutiny and parliamentary and official inquiries were systematically misled for decades about the finances of the industry. But the extraordinary high cost of generating electricity from nuclear power only became public knowledge in 1990 when the then Conservative government was forced to exclude nuclear power from its plans to privatise electricity industry.

The Tory government applied its tried and tested solution to such problems. It repackaged the nuclear power industry to suit the City's needs by hiving off the aging Magnox power stations to the state owned British Nuclear Fuel Ltd (BNFL) and retaining the liability for decommissioning some of the power stations at the end of their commercial life. That, plus a low share price and a suitably generous regulatory price regime, ensured that the sale for £1.5bn of British Energy, as the revamped nuclear power industry was called, went ahead in 1996.

With all but one of its power stations due to close by 2023 and the commissioning of future nuclear power stations unlikely in a liberalised market, British Energy borrowed and went on a spending spree in search of growth. It bought the Eggborough coal-fired power station and electricity and gas supply businesses in Britain and went into joint ventures with AmerGen, owner of the Clinton and Three Mile Island power stations and Bruce Power in North America. Within months, as the price of electricity continued to fall, British Energy was forced to write down the value of Eggborough by £300m and sell its electricity supply business at a loss.

The immediate cause of BE's financial problems was the 40 percent fall in British electricity wholesale prices since 1998. This in turn reflects the huge increase in capacity with the "dash for gas" that came on stream at the end of the decade, encouraged by a generous price regulatory regime and cheap gas. Throughout the 1990s, huge profits were the order of the day, as the utilities' directors became synonymous with greed and "fats cats" in the eyes of the public. There was little mention of the fact that on several occasions the National Grid had come within seconds of shutdown, as the generators closed plants to slash costs. Later, as capacity increased in the late 1990s, wholesale prices started to fall. The net result is that Britain now has 20-25 percent more capacity than it needs to meet peak demand in an average winter. In other words, in the space of a decade, the industry had swung from a modest surplus capacity, to shortage and now over capacity.

The fall in prices is also the result of the Labour government's inauguration in May 2001 of a new regulatory regime under a combined gas and electricity regulator, Ofgem, as part of its populist attempt to rein in the fat cats and reduce prices. The New Electricity Trading Arrangements, known as Neta, reduced prices below the cost of production. Current prices are now about £16.50 per megawatt hour, compared to costs of anything between £18 and as much as £40 for some of the oil fired power stations.

Last May, despite £518m post-tax losses, debts of more than £1bn, accrued nuclear liabilities of nearly £14bn of which only £4bn are fully funded, and warning the government that it needed to be compensated for falling prices, BE paid out £50m to shareholders and announced that it intended to maintain dividend pay outs. It sought to make £280m cost saving, in part at least by negotiating a reduction in the £300m annual cost of re-processing its spent fuel with BNFL or seeking an exemption from the government's climate change levy on the generators.

When metal fatigue in the fans used to cool reactors forced BE to close two of its plants in August, reducing output and revenues, Canadian authorities required BE to make £90m cash payments up front into an emergency fund in case its Canadian subsidiaries were faced with shutdowns. BNFL, in an equally precarious financial position, refused to meet BE's demands and BE announced it faced insolvency without immediate financial assistance.

The crisis has engulfed much of the energy industry, destabilising not just the generators but also the suppliers and distributors. TXU's decision to pull the plug on its European subsidiary follows financial problems of its own that have forced it to make an 80 percent dividend reduction and $320-420 million reduction in capital expenditure.

Two generating companies that supply Powergen, part of the German energy group E.ON, and Scottish & Southern, are believed to have made rival bids to take over UK retail operations. Were TXU to go under, these generators would be badly hit. Were either bid to succeed, heavy job losses would follow.

TXU Europe's collapse follows a long line of US corporations that have sold off their UK subsidiaries to their European rivals such as EdF of France and RWE and E.ON of Germany. Some paid too much for their purchases, others needed the cash to shore up operations at home due to falling prices. In the 1990s, US corporations took over much of the UK electricity industry, one of the world's most liberalised energy markets, as a pre-cursor to taking over European markets that were just beginning to liberalise. But falling prices have put paid to that ambition, and TXU's operations are the last US owned energy subsidiaries in Britain.

Britain led the world in privatising its state-owned enterprises in the 1980s in order to provide the capital markets with new sources of profits. The capital intensive nature of the formerly nationalised infrastructure industries such as transport, telecommunications and public utilities meant that they were never viable longterm propositions. While conditions were good shareholders, directors, top management and their bankers and financial advisors grew rich. When things started to go wrong as it was obvious that they would, the corporations knew that they could turn to the government to help them out since no government could allow essential services to fail. There was an unspoken commitment that tax payers would have to subsidise the banks and shareholders directly.

BE and its bankers are holding a gun to the government's head as BE already had £615m of debt facilities with its bankers—and everyone knows it. While allowing BE to close, thereby reducing Britain's excess capacity at a stroke, appears as the most obvious market solution, this is politically unacceptable. The government is determined to avoid re-nationalisation at all costs, as its manoeuvrings over the failed rail infrastructure company, Railtrack, have demonstrated. Pressure on BE to cut internal costs could compromise safety and no government could risk an atomic accident. Furthermore, as one *Financial Times* commentator put it, "More important, no government could survey a landscape dotted with abandoned nuclear reactors and tell the public the problem was one for market forces."