

Russian power sector reform under threat  
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MOSCOW (AP) - As Russian winter approaches, there are fears Moscow's much-vaunted electricity reform — aimed at heading off looming power shortages — will fall victim to the country's economic crisis.

Investors fear that the climate has frozen the movement toward reform of the country's creaking power system, as Russia's eight-year oil boom has given way to a severe economic downturn on the back of the global financial crisis. Its stock markets have been hammered, Urals oil is trading below \$50 a barrel, and there are concerns the ruble is headed for devaluation.

As the first snow falls in Moscow, some warn that a severe cold spell could bring a repeat of the power cuts of three winters ago. Russia's creaking power system is in dire need of an overhaul. Power stations must be repaired, supply lags an anticipated rise in demand, and funding is short because most electricity prices are still kept low by the government.

"The electricity sector will continue to live on borrowed time, hoping the weather doesn't get cold enough that they'll have power cuts," said Chris Weafer, chief strategist at UralSib bank. "They really are between a rock and a hard place — unless they can find money from someplace. That essentially means going to bed at night and praying for higher oil, and hoping that you're not doing it by candlelight."

Investors are urging the government to stay the course and let rates rise to pay for more investment to rebuild and expand.

"For the government overall, and for the country, the more generation that's built, the better," said David Herne, head of Halycon Advisors, an investor in Russia's power industry. Failure to push ahead with investment now, he said, "could lead to a deficit over the next few years."

Anatoly Chubais, a former finance minister, engineered the privatization of all of the power utilities bundled under the sprawling Unified Energy Systems into regional power companies with names like OGC-1. The reasoning was that private investment was needed if Russia was ever to overhaul its system.

Equally ambitious was the plan to liberalize electricity prices, where industrial users and householders would eventually pay market prices. At present, 75 percent of electricity sold is still subsidized and the electric bill for a Moscow apartment might run to about 600 rubles (\$16.50) a month.

Privatization advocate Chubais has since moved to head the country's nanotechnology program, and some investors fear reform is unraveling.

"We are very concerned that the entire process of reform may be stopping and even reversing. I think that's a very real risk here," said Kevin Dougherty, a portfolio manager at Moscow-based Pharos Fund. "The whole idea of charging market prices for power was always politically contentious. And Chubais ... expended a tremendous amount of energy pushing forward reform."

"But there are many enemies to the reform," he said, and no apparent champions.

Oil companies have written to regulators, requesting a temporary suspension of scheduled rate hikes across the energy and electricity sectors as they struggle in a cheap-oil environment. Backed by a strong lobby in government, they may yet have their way.

"A number of users, particularly oil companies, wish to halt the liberalization" of prices, said Vladimir Shkatov, deputy chairman of Trading System Administrator, a regulator of the wholesale power market, in comments reported by Interfax news agency. "Our view is this: let's wait until the middle of the year, and then we'll see."

Some investors doubt Russia will backpedal on price liberalization. Alexander Branis, chief investment officer at Prosperity Capital Management, a big investor in the power sector, says the oil companies demands are unreasonable, and will receive short shrift from an administration committed to economic reform.

There may be brief respite from the weather and the economy.

Russia has experienced one of its warmest Novembers on record. Meanwhile, metal and energy firms, the power sector's biggest consumers, are using less electricity as they cut operations on the back of the economic crisis, and may prevent the industry from being overwhelmed by a capacity shortage.

Encouraged by the sector's prospects, foreign investors initially piled in. But in recent months others, such as Germany's RWE and the Czech Republic's CEZ, have decided to sit tight amid tough global conditions — potentially denying the industry much-needed investment.

Utility owners, heavily reliant on debt financing, are struggling to raise cash in the tight credit market and have seen a spike in delinquent payments.

Struggling under towering debt, state-run gas giant Gazprom, which also has power assets, said recently it has asked to either cancel some projects or delay them by several years. Renova's Integrated Energy Systems, meanwhile, is seeking to reallocate capacity to locations where demand is more acute, or capacity cheaper to install.

They argue electricity demand is falling — a situation unthinkable a year ago. Alexander Kotikov, a utilities analyst at Troika Dialog, says electricity demand was growing year on year as recently as October, but plunged by 6 percent as of Nov. 18.