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The Chairperson
Taskforce on Review of Power Purchase Agreements
Nairobi, Kenya
May 25, 2021

Via Email:
ppa.taskforce@cabinetoffice.go.ke
pas@cabinetoffice.go.ke

Attention: John Ngumi

Dear Sir,

REQUEST FOR MEMORANDA TO SUPPORT THE REVIEW OF POWER PURCHASE AGREEMENTS

We refer to the above subject and to the gazette notice no. 3076 dated March 29, 2021.

The American Chamber of Commerce (AMCHAM) is a leading business Chamber, whose objective is to drive mutual growth and economic prosperity through increased two-way trade and investment between Kenya and the United States. AmCham Kenya has been working closely with the Kenyan government to promote closer commercial ties between our countries.

AMCHAM proudly supports the government of Kenya's ambition to negotiate a high-standard, comprehensive trade agreement between Kenya and the U.S. Such an agreement has the potential to support the creation of millions of jobs, drive growth in exports for Kenyan and U.S. manufacturers, boost small businesses, power the service economy and grow digital trade.

AMCHAM's members, who include some of the largest multinational corporations have formed an Energy & Infrastructure Taskforce (Working Group) which has been considering various policies to enable the growth of Kenya's Energy & Infrastructure space.

AMCHAM is pleased to provide the attached statement for your consideration in line with the call for public and stakeholder comments.

Should you require any clarifications on our submission below, please do not hesitate to contact me at Maxwell@amcham.co.ke.

Yours Sincerely,

Maxwell Okello
Chief Executive Officer

Statement by the Energy and Infrastructure Taskforce of the American Chamber of Commerce (Kenya)

The following statement is issued by the Energy and Infrastructure Taskforce of the American Chamber of Commerce (Kenya) on behalf of the members of the American Chamber of Commerce (Kenya).

Assessment of Kenya's Electricity Industry

Over the last two decades, Kenya's electricity sector has been the subject of restructuring to encourage private sector investment. In 1996, the government, in its *Economic Reforms for 1996–1998: the Policy Framework Paper*, stated its intention to promote private capital in the sector. Consequent thereto, Kenya Power and Lighting Company (KPLC, now Kenya Power) began tendering and negotiating Power Purchase Agreements (PPAs) with Independent Power Producers (IPPs). The entire process impacted the sector positively and Kenya's power industry became an attractive destination for private sector investment.

Despite the subsequent development of capacity, in 2003, the government in its *Economic Recovery Strategy for Wealth and Employment Creation 2003–2007*, noted that electricity was unreliable and expensive. The following year, the government in *Sessional Paper No. 4 of 2004 on Energy* committed to facilitating the development of a competitive market structure for the generation, distribution and supply of electricity. Kenya went on to liberalize electricity generation and between 2005 and 2015, IPP capacity increased incrementally, accounting for approximately 30% of the country's installed generation and 23% of its production, and representative of investments worth upwards of USD 2.3 billion.

There remains a misconception regarding Kenya's excess capacity. In reality, power generation can vary between 2705MW and 2100MW. Considering a demand of 1980MW at a given time, Kenya only has at most 725MW and at least 120MW excess capacity, assuming none of the capacity is in maintenance. This means, that Kenya is operationally running a tight system.

Kenya's 2030 vision is to become a 'newly industrializing, middle-income country providing a high quality of life to all its citizens in a clean and secure environment'. Electricity is a critical component in the development of the Kenyan economy as it is vital for a wholly energy driven agriculture, Information and Communications Technology (ICT), manufacturing and transport sectors. It is for this reason that the government set out a series of coordinated actions to boost Kenya's power supply, which included sustaining a stable investment climate to allow privatesector participation in the power industry, maintaining a creditworthy off-taker (Kenya Power) and upholding cost-reflective tariffs.

Private-Sector Investment in the Industry

Prior to 1996, Kenya depended on concessional financing from multilateral and bilateral organizations to fund new power projects. However, during the aid embargo imposed on Kenya in the early 90s, it became apparent that government on its own could not support the level of planned expansion investment. It was thus necessary to open up the industry to private sector investment to meet electricity demand. In 1997, the government through the Electric Power Act formally introduced competition in generation and allowed bids for power plants from both public and private firms. Kenya entered into its first set of PPAs soon thereafter to meet capacity shortages. The government decided to limit the period of these PPAs to 7 years, because the government saw them as stop gap power plants at the time. The government also hoped that by the end of the period, less costly, publicly financed plants would be online. Kenya's second set of PPAs were for a period of 20+ years based on the economic life of the plants. This was because Kenya's demand profile was low and IPPs were not prepared to enter the market unless they either had a long term, life-of-plant contract with a single buyer or a liquid market into which to sell the output.

The first set of PPAs were the result of extensive negotiations between KPLC and investors. After the establishment of the Electricity Regulatory Board (ERB) in 1998, all PPAs had to be approved by the regulator. Between 1998 – 2005, a number of PPA negotiations fell through owing to disagreements on tariff rates or rejection of agreed rates by the regulator. Negotiation periods were prolonged on several occasions due to regime changes as well as changes in ERB, ministry and KPLC staff. The bankability of PPAs was also affected by the government's decision not to issue sovereign guarantees unless there was an overriding public interest.

In the years leading up to 2016, there was a markedly improved operational efficiency of the sector thanks to the presence of IPPs. During the same period, PPAs began to be perceived as expensive. Thus, in June 2016, the government established a task force to review all existing PPAs, establish revenue requirements for each, compare their costs against global standards and explore possibilities for mutual termination. The report of that task force was never publicized.

After the year 2016, the government watered down the commitment provided to IPPs in letters of support covering political risks. IPPs also experienced protracted delays in the processing of PPAs. In 2019, Kenya Power froze the signing of new PPAs indefinitely, citing financial constraints and excess capacity. On the cusp of the COVID-19 outbreak, Kenya Power informed IPPs, many of whom had already made payments to contractors and issued construction guarantees, that it would be postponing Commercial Operations Dates in PPAs due to a reduced demand for electricity in the country resulting from the pandemic.

Electricity Tariffs

Electricity tariffs in Kenya have always been the subject of complaints by domestic and small businesses as well as industries for being costly. In 2018, upon an order by President Uhuru Kenyatta to review the tariff rates downwards, Energy Regulatory Commission (ERC, now Energy and Petroleum Regulatory Authority) reviewed, approved and published a new set of Retail Electricity Tariffs to replace the tariffs approved in August 2018. Changes on the set tariffs have been minimal.

The average electricity tariff in Kenya is USD 0.208/kWh for households and USD 0.167kWh for businesses which includes all components of the electricity bill such as the cost of power, distribution and taxes. Globally, the average electricity tariff is USD 0.138/kWh for households and USD 0.124/kWh for businesses.

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Reforms in the energy sector have enabled a realistic review of electricity tariffs to incorporate changing macroeconomic conditions. The Energy Acts of 2006 and 2019 provide for the review of electricity tariffs every three years. EPRA, however, has delayed/amended rates outside of the 3-year period, partly due to government seeking to ease inflationary pressure on households and industries. The Acts also provide for the activation of a Feed-in-Tariff (FiT) policy for power sourced from renewables.

Kenya Power is now pushing EPRA to review electricity tariffs upwards to generate revenue to cover costs of capital-intensive building and maintaining of the nationwide electricity distribution infrastructure. Kenya Power has largely attributed its revenue loss to the tariff cuts of 2018 amidst high service costs from a growing customer base.

In Q4 2020, EPRA agreed to hike electricity tariffs by at least 20% subject to an application submitted by Kenya Power. This is still pending approval. The hike, if implemented, will cushion Kenya Power's recovery/turnaround efforts, but raise the cost of doing business.

<u>Challenges in the Industry</u>

The appointment of the 2021 presidential taskforce to review and analyze PPAs comes against the backdrop of great financial strain and rising debt on the part of Kenya Power as well as high power tariffs. It is however worth noting that:

A. The existing PPAs were procured on the basis of data-driven demand projections by government;
B. All signed PPAs were the product of competitive and direct negotiations and the set tariffs were approved by the industry regulator;
C. Whilst PPAs are said to have contributed to excess generation capacity, Kenyans and businesses in Kenya still experience unreliable electricity and intermittent blackouts/brownouts. This is predominantly a demand, transmission, distribution and supply issue yet there are no corresponding discussions on increasing demand, grid upgrades, grid resilience and investments in energy storage;
D. Merchant power plants are designed for competitive wholesale power marketplaces. They are built to sell to competitive, spot markets, which do not currently exist in Kenya and would require significant regulatory structure and financial liquidity to thrive. Even in established markets like the United States and Europe, merchant power projects are very risky propositions that are difficult to finance and often require more equity investment. If Kenya moves to a take-and-pay merchant arrangement, no projects would be advanced by the private sector and new capacity would need to be arranged by Kenya Power;
E. Power is a capital-intensive sector with a considerably long gestation period, therefore, continuity and clarity of policy are a prerequisite for private-sector investments. Any disregard of the terms in the signed PPAs will undermine the sanctity of the contracts and adversely impact the investment climate by dampening investor confidence and will magnify the risk a project could undergo during its PPA tenure which would result in high project costs that would be passed through to consumers in the form of higher tariffs – the very issue that the review of PPAs is supposed to resolve.

Conclusion

Adequate, secure, and competitively priced electricity is vital for powering economic growth and development. With increasing urbanization and industrialization, the demand for power in Kenya is forecasted to grow. While this will bridge the gap between generation capacity and demand, the greater challenge will be to meet succeeding demand.

All through the years, Kenya has been an appealing investment destination due to its overall adherence to the rule of law and transparency. Indeed, IPPs in Kenya have undoubtedly made an important contribution in meeting the country's overall power needs. Disincentivizing the private sector to invest by reallocating risk to IPPs will have an adversarial impact on the inflow and long-term sustainability of the sector and hamper the country's ability to create a robust and low-cost energy sector for the coming decades. Additionally, uncertainty created in investing in the power sector will have a spill-over into other sectors of the economy as Kenya will be viewed as an uncertain investment destination, thus curtailing Kenya's attractiveness.

The American Chamber of Commerce (Kenya) encourages American companies to consider Kenya as a base for manufacturing and one of the benefits that Kenya has had over other African countries is its diverse and reliable power industry as well as the Government's reputation for protecting investors by honoring its long-term commitments. Accordingly, the American Chamber of Commerce (Kenya) is on hand to work closely with the taskforce and all relevant stakeholders to discuss and develop an arrangement that will accommodate the interests of the off taker, generators, consumers as well as the Kenyan taxpayer and will preserve the investment climate in the country.