POWER TO AFRICA VOLUME 3:

Kenya – Part 1

June 2017

Following our reports on Nigeria and Ghana, this third instalment of our Power to Africa series will look at the power sector in Kenya.

In this first part, we will explore the current legal framework as well as the key players in the industry before addressing the challenges and opportunities facing potential power sector investors in Kenya in Part 2.

Introduction

Kenya has a population of 48 million people and is East Africa's largest economy. It is seen as a stable and attractive entry point into the common East African Community market of 150 million people.

Kenya is considered to have a strong private sector and a relatively diversified economy. The country has a young population and so stands to benefit from a demographic dividend. In all, the country's medium to long term economic outlook is positive. General elections are set for August 2017 though, with the incumbent, Uhuru Kenyatta, expected to win. However, elections in 2007 resulted in ethnic violence causing some unease to investors and hopefully such events will not mar the elections later this year.

Biomass, petroleum and electricity make up the three main sources of energy in Kenya, at 69%, 22% and 9% respectively. Electricity is generated primarily from geothermal and hydro sources, making up 47% and 39% respectively. Wind, on the other hand, only accounts for 1% of the installed capacity (Kenya Electricity Generating Company Limited).

As at June 2016, Kenya's installed generation capacity was 2,341 MW, well short of the target of 5,000 MW set by the Government of Kenya (GOK) in 2008. The GOK has announced that access to electricity has increased from 23% of the population in 2013 to 65% at the start of 2017. According to Kenya Power and Lighting Company (KPLC), 63% of households are currently connected to the grid and it is targeting 70% by the end of 2017.

Legal Framework

The following legislation and policies (listed chronologically) set out the operational landscape and governmental strategy for the power sector in Kenya.

Sessional Paper No.4, 2004 on Energy (the Sessional Paper)

The Sessional Paper is an instrumental piece of legislation which lies at the heart of power sector reform in Kenya. It restructured the power sector to boost investment and growth with the principle aim the enacting a new and robust energy act, achieved 2 years later. It sought to increase private sector participation through regulatory reforms including the creation of a common energy sector regulator, the Energy Regulatory Commission (ERC).

The Sessional Paper also led to the unbundling of distribution and supply, the introduction of feed-in tariffs, the promotion of renewable sources of energy and the creation of a PPP framework.

The Energy Act 2006 (the Act)

The Act consolidated the previous electricity and petroleum acts. Among other things, it provided for the establishment, powers and functions of the ERC and the Rural Electricity Authority. Directions on renewable energy, energy efficiency and conservation were also address in the Act.

Kenya Vision 2030 (the Vision)

The country's economic blueprint was launched in 2008 with the long-term aim of "transform[ing] Kenya into a newly industrialised, middle-income country providing a high quality of life to all its citizens by 2030 in a clean and secure environment". Power is one of the 8 key sectors highlighted by the Vision to enable its ambitions.

Through the Vision, the GOK aims to increase generation capacity in Kenya to 23,000 MW by 2030. This is a tall order given that it is currently in its second Medium Term Plan (2013-2017) which aimed to increase installed capacity by 5,538 MW in 2017 through a mix of hydropower, geothermal, wind power, coal, liquefied natural gas and imported power, and this target will not be met.

The Constitution of Kenya 2010 (the Constitution)

The Constitution was enacted on 27th August 2010 replacing the Independence constitution of 1963. Over 67% of voters approved the 2010 Constitution in a referendum. Amongst others, it revised the structure of government as well as devolving power to a more local level.

Significant principles regarding land ownership were also covered in the Constitution, including access and security of tenure. This is of particular importance to project investors and developers and will be touched on further in Part 2.

National Energy and Petroleum Policy 2015 (NEPP)

The NEPP is a draft policy issued by the Ministry of Energy and Petroleum which seeks to build on the Sessional Paper and to assist the aims of the Vision. Its mission "for all Kenyans …[is to] facilitate provision of clean, sustainable, affordable, competitive, reliable and secure energy services at least cost while protecting the environment".

The NEPP seeks to increase competition, incentivise FDI and local investment in the sector and a review of the existing feed-in tariff policy.

In line with the devolved structure of government set out by the Constitution, two draft bills were also published alongside the NEPP to execute its objectives: the Energy Bill 2015 (the EB) and the Petroleum (Exploration Development and Production) Bill 2015 (the PEDDB). The EB seeks to loosen the current licensing regime for electricity generation, transmission and distribution and to consolidate the regulation of electricity and renewables. The PEDDB seeks to update the existing regulatory framework and to provide the terms of a new model product sharing contract.

Both acts also seek to establish a number of new regulatory bodies which has been met with some resistance given their aims of streamlining the existing frameworks.

Feed-in Tariff Policy (FiT Policy)

In line with its ambitious power access targets, Kenya's FiT Policy takes a long-term view regarding renewable resources and mandates a power purchase agreement (PPA) of a minimum of 20 years. A typical PPA will provide for payment 30 days after receipt of an invoice by KPLC and for amounts to be paid in a foreign currency.

Nuclear

The Kenya Nuclear Electricity Board announced in 2016 that it had signed a deal with China as part of a plan to generate nuclear power of 1000MW in Kenya by 2027. Nuclear power cooperation agreements with Russia and Slovakia are also in place with another signed with South Korea in 2016. The GOK has ambitious plans to raise nuclear capacity to 4,000MW by 2033.

Key Players

A summary of the key players in the power sector in Kenya is as follows:

Ministry of Energy and Petroleum (MEP) formulates policy on the energy sector

Kenya Power and Lighting Company (KPLC) owns and operates most of the electricity transmission and distribution system (50.1% state owned)

Kenya Electricity Generating Company (KenGen) manages and develops all public power electricity generating facilities (70% state owned)

Energy Regulatory Commission (ERC) reviews electricity tariffs and enforces safety and environmental regulations in the power sector. It also issues permits and licences.

Rural Electricity Authority (EA) implements rural electrification projects

Kenya Electricity Transmission Company (KETRACO) constructs and operates new transmission lines (100% state owned)

Geothermal Development Company (GDC) develops steam fields to reduce upstream power development risks and promote rapid development of geothermal electric power (100% state owned)

Kenya Nuclear Electricity Board (KNEB) was established in 2010, tasked with driving Kenya's nuclear energy generation programme.

Independent Power Producers (IPPs) - there are approximately 10 in operation

Fiscal Incentives

In order to attract more investment into the energy sector, The GOK has introduced various tax incentives. The key directives are as follows:

→ **Legal Notice 91 (2015):** exempts withholding tax on payments of interest on loans from foreign lenders provided loan proceeds were used for infrastructure investment (including in the energy sector);

- **Legal Notice 106 (2015):** exempts from stamp duty instruments executed on transactions involving loans from foreign sources received by investors in the infrastructure development sector (which includes the energy sector); and
- **Legal Notice 165 (2015):** exempts withholding tax on payments made to a non-resident for services rendered under a Power Purchase Agreement. The usual rates are 15% on interest and 20% on management fees when paid to a non-resident and if no double-taxation treaty is in place.

In addition, there is zero rating of export duty and a removal of VAT and customs duties on equipment used in electricity generation (including renewables). Kenya is also seeking to increase the number of double-taxation treaties it has as well as enhancing those that are in place already.

Conclusion

As East Africa's largest economy, and with a strong private sector and a young, increasingly educated population, Kenya is a key player in Sub Saharan Africa. Whilst there are some socio-political issues still to iron out, the country's medium to long term economic outlook is positive.

However, Kenya is now facing a possible period of change as elections loom in the latter half of 2017. Whilst indications point towards the current government remaining in power, investors may be right to enter Kenya cautiously until the elections and any political unrest has died down.

Part 2 will look at this issue, as well as some other challenges that the power sector in Kenya faces, and highlight some of the potential opportunities which, to the extent maximised by market participants, could address these challenges.

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