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SCALING UP:

THE POTENTIAL OF KENYA'S PROPOSED RENEWABLE ENERGY AUCTIONS POLICY

Like many other developing countries, Kenya requires low-cost electricity to boost economic growth. Various key sectors would benefit from cheaper electricity. For example, the manufacturing sector would be able to offer competitively priced goods in the global export markets, whilst large infrastructure projects would benefit from increasingly attractive returns. Above this, there has been widespread concern about the high cost of electricity in Kenya. This is amongst one of the factors that prompted the President, H. E. Hon. Uhuru Kenyatta, to appoint a taskforce to review Power Purchase Agreements (**PPAs**) on 29th March 2021.

This article will explore one of the means of procuring competitively priced generation tariffs, being renewable energy auctions. The adoption of renewable energy auctions has increased significantly across the globe as more countries look to this method as being effective in the price discovery of power projects. With a global shift towards the use of renewable energy, countries are procuring renewable energy through auctions as a means of leveraging on the market-based prices and competitive nature of auctions. Auctions envisage a competitive bidding process for the procurement of renewable energy, where bidders are evaluated solely on a set criterion determined by the government.

Since 2008, Kenya has procured its renewable energy under the Feed in Tariffs Policy on Wind, Biomass, Small-Hydro, Geothermal, Biogas and Solar Resource Generated Electricity, which was last revised in 2012 (**2012 FiT Policy**). To power project developers and their investors, the 2012 FiT Policy is ideal because of the tariff guarantees, which allow power generators to sell the generated electricity at pre-determined tariffs under standardized PPAs for a specified period.

However, while the 2012 FiT policy offers lower pre-determined tariffs, investors have on numerous occasions made submissions for generation tariffs higher than those contemplated under the 2012 FiT Policy. Following this trend, there was a proposal to review the 2012 FiT Policy with a view to maintain the lower pre-determined tariffs and introduce renewable energy auctions to handle the submissions for higher generation tariffs. Additionally,

in 2016, the Ministry of Energy undertook a feasibility study to explore the practicality of introducing renewable energy auctions. Renewable energy auctions were first contemplated in the Energy Act, 2019 (**the Energy Act**) where under section 119 (2), the Energy and Petroleum Regulatory Authority can through a fair, open and competitive process issue a generation licence.

In January 2021, pursuant to this provision of the Energy Act, the Ministry of Energy released the draft Renewable Energy Auctions Policy (**Auctions Policy**). Once approved, the Auctions Policy will ensure that renewable energy is procured competitively and in line with the Least Cost Power Development Plan (**LCPDP**) / Integrated National Energy Plan (**INEP**). The Auctions Policy is yet to be approved by the Ministry of Energy and its implementation will be dependent on the recommendations of the Presidential Taskforce on the Review of PPAs.

Scope of the Auctions Policy

If approved by the Ministry of Energy, the Auctions Policy will govern the procurement of all solar, wind power, and other renewable energy projects larger than 20MW, to the exclusion of geothermal projects. Notably, Small Hydro power projects not exceeding twenty megawatts (20 MW), Biomass and Biogas projects will be procured under the 2021 Feed in Tariffs Policy on Renewable Energy Resource Generated Electricity (Small-Hydro, Biomass, Biogas) (**2021 FiT Policy**), while geothermal power projects will be procured under the Policy on Licensing of Geothermal Greenfields.

Secondly, the Auctions Policy will apply to all solar and wind power projects that are currently under the 2012 FiT Policy but have not signed a PPA, despite having an approved Expression of Interest. The Auctions Policy will be subject to review every five (5) years from the date of its publication, subject to exceptional cases that may warrant an earlier review. Once reviewed, the Auctions Policy will apply prospectively to power projects.

Role of the Ministry of Energy

The Ministry of Energy will be tasked to announce the auctions

upon receiving advice from the LCPDP/INEP Committee on the appropriate timing and targeted capacity. The Ministry will further have the responsibility of determining the site selection requirements necessary for bidders to participate in the auctions. As part of its guiding role, the Ministry of Energy will provide the bidders with the information necessary to prepare their proposals.

The Auction Mechanism

Once approved, the renewable energy auctions under the Auctions Policy will be done through a two-stage bidding process, with the first one being the prequalification stage, where bidders will undergo a preliminary evaluation process, and the second stage, where the bidders undergo a technical and financial evaluation (if they pass the first stage).

Stage 1 (Preliminary Evaluation)

At the preliminary evaluation stage, bidders will have to demonstrate that they have: the requisite experience to implement the project; sufficient financial capability; an appropriate (stage 1) bid bond; land rights/access rights to the plant and interconnection infrastructure; the proposed technology, preliminary design/configuration, scale and annual energy is viable and consistent with the site constraints as outlined in the maximum megawatts export rating from the site; the proposed grid connection route; and provision of constitutional documents. Bidders who successfully demonstrate the above will be invited to submit a full proposal for the second stage of the auction mechanism. For unsuccessful bidders, the bid bond submitted during stage 1 will be returned to them.

Stage 2 (Detailed Technical and Financial Evaluation)

For the detailed technical evaluation, the successful bidder will be required to submit a proposal in response to a Request for Proposal; a sealed price bid; and a stage 2 bid bond. The sealed price bid will not be opened until the bidder successfully passes the second stage of the auction mechanism. At this stage, the bidders will receive their stage 1 bid bond. The stage 2 bid bond is returned to the bidders who are unsuccessful in this second stage.

Once implemented, Kenya will be well placed to benefit from the following advantages of this procurement method:

a) Enhanced Competition and Transparency

By their very nature, renewable energy auctions are a competitive way of procuring electricity. The auctions require participants to submit their bids for the development of power projects, and the bids are then compared against each other to determine the lowest possible bid. This comparison of bids allows for competitive pricing of power. Renewable energy auctions also create market opportunities for investors in the electricity sector and allow consumers to benefit from low electricity prices as a result of the competition.

b) Price Discovery Mechanism

Unlike FiT Policies, the proposed Auctions Policy will not apply pre-determined tariffs as the tariffs will be determined on a market basis. This gives way for the application of price discovery, which is the process of determining the spot price for renewable energy based on factors such as supply and demand. Bidders will state the price they are willing to sell their renewable energy for, while buyers will indicate the price they are willing to pay for the renewable energy. Through this price discovery, parties can find an equilibrium price. A price discovery mechanism will further enhance energy sector planning by improving the ability of the relevant stakeholders to assess what renewable energy is undersubscribed or oversubscribed in the renewable energy auctions.

c) Reduced Demand Risk

Demand risk exists where the demand for power is higher or lower than what was projected by the relevant stakeholders. The country's current energy strategy seeks to mitigate this risk by ensuring

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that the LCPDP is aligned to the proposed Auctions Policy to ensure that the projected demand meets the country's energy needs. Therefore, while the LCPDP ensures that the correct demand is projected and the project pipeline is clearly determined, the Auctions Policy ensures that the auction-specific projects under the LCPDP are implemented.

The implementation of the Auctions Policy seems inevitable. This notwithstanding, the Ministry of Energy needs to consider gaps that might undermine the success of the Auctions Policy in Kenya.

a) Absence of Deadlines and Penalties

As currently drafted, the Auctions Policy lacks an accountability framework. For example, there are no consequences under the Auctions Policy for a bidder who fails to develop a power project within a prescribed time upon winning a bid.

To remedy this, the possible challenges associated with the proposed renewable energy auctions need to be identified, and stakeholders must determine what penalties and deadlines would be best suited to address these challenges. However, these punitive measures ought not to be counteractive. Excessive deadlines and penalties might lead to high bids for power projects to avoid the adverse effect of tight deadlines. More specifically, to cater for the penalties, bidders would increase the price of their submitted bids, ultimately leading to higher electricity costs for consumers.

b) Risk of Collusion between the Bidders

The success of the Auctions Policy is pegged on ensuring that the process is competitive and free from influence. However, there is a risk that participants in the renewable energy auctions might collude to drive up the prices of electricity and exclude other bidders from the process.

A renewable energy auction can either be static or dynamic in nature. Under a static auction, the participants submit the bids simultaneously while under a dynamic auction the participants submit their bids through several rounds. A static auction is one way of dealing with collusion as the bidders are unaware of the other participants' bids. However, under a dynamic auction, participants are able to see the other bids and amend their bids accordingly. Therefore, static auctions are ideal for countries which are new to renewable energy auctions as they can reduce the risk of collusion.

c) Absence of a Ceiling Price

A ceiling price is the price at which bids are capped, with bids submitted above this price being disqualified. Creating a ceiling price under the Auctions Policy would allow the Ministry of Energy to control the price of electricity and ensure that it is affordable for consumers. Where auctions are undersubscribed, a ceiling price ensures that bidders do not price their electricity at exorbitant prices. However, it will be important for the Ministry of Energy to disclose, in advance, the ceiling price to bidders once the same is determined. This is to ensure that genuine bidders are not disqualified for pricing their bids above the ceiling price because of lack of knowledge.

Conclusion

While Kenya is on the right path towards implementing renewable energy auctions, a lot is yet to be done to ensure its success. The power sector stakeholders face a tall order to ensure that the country not only benefits from the Auctions Policy, but that the gaps in the proposed Auctions Policy are addressed.