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Our Ref: KPLC1/1/8C/18/JKN/fo

22nd February, 2013

Mr. Stephen Mutoro,
Secretary General,
Consumers Federation of Kenya
P O Box 2733-00200, City Square,
NAIROBI.

Dear Stephen

RE: CLARIFICATION ON THE PROPOSED RETAIL TARIFFS INCREASE

Thank you for your letter dated 21st February 2013. Below are clarifications to issues raised therein in the order in which they appear.

(a) Why the Application which was deferred in 2011 was not publicly shared earlier.

The Application filed by KPLC in February 2011 at the end of the tariff review period of three years was in line with the tariff setting policy of the Energy Regulatory Commission (ERC), but was deferred because the power projects which would have necessitated the increase had just been tendered for, and therefore their revenues were not immediately required.

These power projects which form part of the country's Least Cost Power Development Plan (LCPD) with an aggregate capacity of 1,248, are being developed by Independent Power Producers (IPPs) and the Kenya Electricity Generating Company (KenGen). They are at advanced stages of implementation and some will be come into operation in March and May 2013, while the rest will be commissioned in early 2014 and 2015.

(b) Why the implementation of the agreed rates cannot be effected after 6 months.

As detailed in the Tariff Review Application, payment obligations for the power capacity from the plants under construction will be applicable once each of the plants is commissioned. Some of the power plants will be commissioned in March-June 2013, while the rest will come into operation between June 2013-2015.

(c) With the proposed mass installation of prepaid meters, what will be the justification for additional fixed charge? Why should the current cost of Shs.120 not be phased out by 2016?

The Company meets the cost of installation of meters, including software licences, upgrades and replacement. The cost of meters has been increasing with changing technology, for example from analogue to digital technology. The fixed charge is a rental and administrative charge for meters. The prepayment meters do not eliminate this cost.

(d) The main burden being thermal plants where your fuel cost adjustments amounts to nearly 40% and thermal generation accounting for nearly 30% of electricity production mix, what bankable assurance is there for the consumers that there will be no future licensing, expansion and/or extension of thermal generation?

Development of power generation capacity is guided by a national least cost development plan (LCDP), which is developed in consultation with various stakeholders. The current LCDP seeks to ensure the development of a diversified portfolio of power generation assets that are expected to shift over time from increasingly unpredictable hydropower and fuel price-sensitive thermal options to greener, cheaper technologies such as geothermal and wind, in addition to cheaper regional hydro imports. As an interim measure, thermal generation plants will be relied on to partly meet current power shortfall and reserve margin, until the greener cheaper plants are developed, after which the thermal plants will transition from base-load to intermediate duty.

PLANNED DIVERSIFIED POWER GENERATION SOURCES 2012-2020

Year	Hydro	Medium speed diesel	Import	Cogeneration	Gas turbine-kerosene	Gas turbine/natural gas	Geothermal	Coal	Wind
2012	50.6%	30.1%		1.7%	4.0%		13.2%		0.3%
2015	26.5%	29.2%		0.8%			26.6%		16.9%
2020	16.1%	15.0%	15.5%			5.6%	26.8%	9.6%	11.4%

(e) To what extend does 'cost-reflective' terminology used in your application as a justification for the steep rates apply to cost-effectiveness in terms of determining the proposed prohibitive rates?

The tariff takes cognisance of the purchase of generation capacity and energy, operation and maintenance of the transmission and distribution system and also return and taxes on regulated asset base. Notably, the current base rate is adjusted every month and six months for forex and inflation, respectively, and therefore the effective current energy cost payable by consumers compared to the base rate proposed in the tariff application indicates a marginal increase in view of the adjusted base rate for forex from US$64 in 2008, to US$86.

(f) What if the additional capacity envisaged by 2016 is reduced by half?

The country has suffered perennial power capacity shortfalls for many years due to delays/ lack of investment and development of generation capacity in accordance with the LCPD. The planned projects are meant to bridge this shortfall as well as meet the demand in accordance with the LCPD. Already, the current demand is suppressed by about 200MW, while the system has 120MW emergency power capacity which needs to be replaced with cheaper plants. Additionally, of the 1,250MW of power planned to be commissioned by 2015, 510MW is from wind sources, which is not a firm capacity, but which when available is beneficial as it displaces the more expensive energy from thermal sources. In addition, the average time for procurement of generation capacity is about 2-3 years. By reducing the planned additional capacity by half, inadequate capacity would lead to prolonged rationing or planting of additional emergency thermal plant which will be expensive for the economy due to the fuel cost charge.

(g) **Strategic Innovations to lower operations, maintenance, etc.**

KPLC is continuously undertaking mechanisation and automation of its operations in order to become more efficient. Further, the Company partners with various service providers such as Safaricom, Postal Corporation of Kenya and banks to offer alternative bill payment options. A project to automate the power distribution network has been completed in Mombasa and will be commissioned in Nairobi in the course of this year. The automation reduces the time taken to restore power in the event of system breakdowns.

Plans are at an advanced stage to underground the distribution network in Upper Hill, Lavington and Kilimani; Westlands, Parklands and Ngara areas of Nairobi; and the central business districts of Kisumu and Mombasa. Undergrounding reduces maintenance costs and system breakdowns as well as vandalism.

(h) **What is the feasibility of a joint stakeholders' group being constituted by the regulator to work on mechanisms in which your proposed rates can be reduced and/or be staggered into the future to allow for the time when the impact of thermal generation will hopefully be reduced by having more contribution from cheaper alternatives such as geothermal and wind?**

This has already been taken into consideration. (See 'd' above). Stakeholders in government and private sector are regularly consulted in planning for power in forums such as the Energy Conference held every 1-2 years, and other forums that are spearheaded by the Ministry of Energy.

(i) **To what extent do the proposed tariff adjustments address the perennial customer-care challenges?**

The Company will invest USD530 million in the next five years in the system to improve the quality of power supply.

(j) **Has KPLC/ERC had any independent assessment of the dire implications to inflation, commodity pricing and the economy should the proposed steep rates be implemented at once?**

The current effective energy cost being paid by consumers of about KShs.16.62 per kwh is proposed to increase by 8% to KShs.17.98 in 2012/13 financial year; by 7% to KShs.19.17 in 2013/14; and thereafter **reduce** by 20% to KShs.15.38 in 2014/15 and **further** by 3% to KShs.14.85 in 2015/2016.

In the absence of the required revenues to meet the financial obligations for the additional capacity necessary to meet the demand to 2016, the economy would suffer a loss of 84 US cents – US$1 per kwh, being the cost of not supplying electricity to the economy.

Yours Sincerely

ENG. JOSEPH K. NJOROGE, MBS
MANAGING DIRECTOR & CEO