Scoping Workshop Report on competition policy and regulations in Kenya's energy sector Held at the Panafric Hotel, Nairobi, Kenya 20th November 2008.

1.0: Background.

The workshop was based on the premise that in Kenya, economic reforms in many sectors began in the 1980's through the Structural Adjustment Programmes. Competition laws were enacted under the Restrictive Trade Practices, Monopolies and Price Control Act of 1989. The intentions of the law are to allow government to encourage competition in production of goods and services and reduce direct control of prices in the entire economy. The Act specifically provides for the control of restrictive business practices, the control of monopolies and concentration of economic power and the control and display of prices. In the energy sector, structural changes in the electricity sub-sector commenced with the enactment of the Electric Power Act, 1997 whereby the Kenya Electricity Generating Company (KenGen) assumed the responsibility of power generation while the Kenya Power and Lighting Company took the responsibility for power transmission and distribution. The Act also established the Electricity Regulatory Board (ERB) to set, review, adjust consumer tariffs and promote competition among other responsibilities (GoK, 2004; IEA, 2003). On the other hand, the regulatory functions within the petroleum sub-sector were shared amongst various players including the ministries of Energy, Local Authorities and Provincial Administration. Later, the Energy Act 2006 consolidated all laws relating to energy and provided for the establishment of the Energy Regulatory Commission (ERC) as a single sector regulatory agency with responsibility for economic and technical regulation of electric power, renewable energy and petroleum sub-sectors.

Despite of the existence of this Regulatory framework, several concerns have been raised about the state and performance of energy sector in Kenya. The concerns touch on a range of issues including among others, relatively high and escalating consumer prices, unreliability of energy supplies, entry barriers for provision of services, collusions and environmental concerns. These complaints come at a time when the sector has witnessed the disintegration and consolidation of a number of operations and segments in the sector. In the power sector, consumer tariffs are relatively high and out of reach for the low-income group majority of who live in the rural areas. Kenya's electricity tariffs do not compare well with major trade competitors. For instance, while it costs US$ 6.8 per kWh in Kenya, the same goes for US$2.4/kWh in South Africa, US$1.5/kWh in Egypt and US$5.5/kWh in Mauritius (Mwangi et-al, 2003). The relatively high tariffs lead to increased cost of production in the manufacturing sector thereby reducing the competitiveness of Kenyan products in external markets. In the 1990's, especially during drought periods, an average of 20,000 jobs were being lost every year following closure or relocation of industries to other countries due to costly and unreliable energy.

The petroleum industry does not fair any better. Today, the petroleum industry is constrained by limited supply of fuels including LPG, domestic production of motor fuels which do not meet internationally quality standards, inadequate distribution infrastructure especially in remote areas, price leadership which inhibits competition and insufficient legal and regulatory framework to guide the sub-sector operations in consonance with international best practice. In addition, the liberalisation of the petroleum industry in 1994

has resulted in the entry of new players some of who not only compromise safety, health and environmental standards but also deny government fiscal revenue through dumping of export fuels and adulteration of motor vehicle fuels with lowly taxed kerosene. Besides, the impact of oil prices and the increased affinity for oil use implies enlarged import bills and balance of payment problems. At the micro level, increased oil prices reduce household disposable incomes (available for other needs) and raises production costs in most sectors, including both industry and agriculture, hence damaging competitiveness (UNCTAD, 2006).

CUTS international in collaboration with ICBE research fund has conceived a research project on **competition policy and regulations in Kenya's energy sector to** review and assess the competition policy and regulations vis-à-vis the energy sector reforms in Kenya. It is in this regard that a scoping workshop was organised on **20th November 2008** with the main objective of seeking views from relevant stakeholders to enrich the scope of the research.

The meeting was attended by government officials from the ministry of trade, representatives from research institutions, private sector organisations, and civil society organizations, representatives from regulatory agencies such as competition authorities, National chambers of commerce, and donors.

1.1.0 Session 1: Background of the Study and Terms of terms of reference.

Presentation by Ms. Grace Njeru

It is recognised that world economic reforms are anchored by privatization and liberalisation where privatisation is a global trend for infrastructure financing and development in major sectors which include power, water, transport and telecommunications. Necessary regulatory measures should be put in place to ensure operational efficiency and competitive provision of services within the sectors. Competition is accentuated to play a major role in ensuring that firms produce and distribute products at the lowest cost. Thus protects the consumer's welfare by ensuring that the products are availed at the market at the lowest prices and affordable prices. Competition in the market economy facilitates the introduction of new products or processes and new markets. This helps in enhancing technological advancement and high quality products.

Competition is important for healthier and efficiency in market operations. However, the degree of competition in a market economy should be recognized .A degree of competition that would propel investment should be determined. In this regard, a competition policy and regulation remain instrumental in eliminating anti-competitive and restrictive business practices in the economy. Various approaches to the enforcement of competition law and sector regulations have been identified by various studies. For instance, UNCTAD (2006) identifies the following five approaches:

- Combination of Technical and Economic regulation in a sector regulator and competition enforcement by the Competition Authority;

- Combination of Technical and Economic regulation in a sector regulator and some or all competition law enforcement functions;
- Combine of Technical and Economic regulation in a sector regulator and give it competition law enforcement functions which are to be performed in coordination with the competition authority;
- Maintain Technical regulation as a stand-alone function for the sector regulator and include economic regulation within the competition authority.
- Full reliance on competition law enforced by the competition authority.

2.0: Competition Laws and Energy-Sector Regulations

Competition laws in Kenya were enacted under the cap 504 on Restrictive Trade practices, Monopolises and Price control Act of 1989.This act provides for the encouragement of competition in the economy by prohibiting restrictive trade practices, controlling monopolies, concentration of economic power and prices. Institutionally, the commissioner for monopolies and prices makes recommendations to the minister of finance.

2.1.0: Energy Sector in Kenya

The energy sector in Kenya is composed of Biomass, fossil fuels, electricity and other renewable energy as the major sources of energy. The commercial energy is dominated by wood fuel 68%, petroleum 22%, Electricity 9% and others including coal and solar (1%).The energy sector in Kenya generates its electrical power from Hydro(60%),Thermal oil(30%), Geothermal(10%),co-generation(0.09%),wind(0.01% and imports(0.2%). Despite of the various sources of energy in Kenya, the scope of the study will mainly focus on sector electricity and petroleum sub-sectors.

2.2.0: Policy and Regulatory Framework

In the context of the energy sector in Kenya, it is considered that broad policy objective would lead to affordable and easy access to quality energy sources. The regulatory framework constitutes institutions, laws, policies and administrative rules governing entry, ownership pricing, and access and service standards. The need for economic and technical regulation of electric power, renewable energy and petroleum sub sectors conceived the establishment of the Kenya Energy Act in 2006 and created the Energy Regulatory Commission (ERC) to regulate the sector. The commission is specifically to play the following roles:

1. Regulation –
    - Importation, exportation, generation, transmission, distribution, supply and use of electrical energy;
    - Importation, exportation, transportation, refining, storage and sale of petroleum and petroleum products;
    - Production, distribution, supply and use of renewable and other forms of energy;
2. Protection of interests of consumers, investors and other stakeholder interests;

3. Monitor, ensure implementation of, and the observance of the principles of fair competition in the energy sector, in coordination with other statutory authorities

3.0: Research Problem.

The envisaged study is driven by the following weaknesses in the energy sector:

- Weak enforcement of competition-related regulations.
- Market failures i.e. monopolistic tendencies in generation, distribution and transmission of electric power.
- Constrained demand for services i.e. low access rates for electricity i.e. 15% national, 4% in rural areas.
- Low consumption i.e. 121kwh per capita, per capita 4595.
- High consumer prices for electricity and petroleum products
- Lack of clear guidelines and framework for enforcement of competition related regulations.

4.0: Objectives of the Study.

- Assess the institutional framework of the national competition policy and regulatory structures.
- Review and evaluate the competition policy and regulatory framework of the energy sector in the light of energy sector reforms.
- Undertake a comparative analysis of competition and regulatory framework in energy sector in other countries.
- Make policy recommendations.

5.0: Terms of Reference

The following are the proposed terms of reference based on the above study objectives.

5.1.0: Review of competition and regulatory structures in energy sector.

This will involve the developing an analytical framework-best practices independent regulator model, review competition and regulatory frameworks in other developed and developing countries with a view to drawing lessons from their successes and failures and develop policy options ,that have been determined to achieve success will be developed based on the these interventions.

5.2.0: Review of Kenya's competition and regulatory framework in the energy sector.

This will involve the desk review of the relevant literature including the restrictive trade practices, Monopolicies and price control act of 1989 and the energy Act of 2006 will be undertaken to gauge their effectiveness in regulating the energy sector.

5.3.0: Field Work and Stakeholder Workshops

Stakeholder's workshops to clarify the rooms for interventions will be held. This will involve the scoping and validitation workshops .Field Surveys will be undertaken to gain further insights into issues and opinions on the war forward.

5.4.0: Final Report and policy Brief

This will involve a report on experiences and lessons learnt on the competition and regulatory framework. A policy brief on appropriate policy options aimed at enhancing competition and regulatory framework in Kenya will also be developed.

Plenary Discussions and Summary of recommendations.

- There was a consensus that the study is extremely relevant and quite opportune and it was clarified that electricity and petroleum sub-sectors are the major sectors in consideration.
- Kenya passed the Energy Act in 2006 and created the Energy Regulatory Commission (ERC) to regulate the sector, which is a step in the right direction. However, there has to be an assessment whether the regulatory framework as provided under the Act is effective enough to protect the interest of both producers and consumers.
- It was felt that the government could explore the possibility for infusing competition in electricity generation and distribution business (which are presently controlled under government owned monopolies), by opening up these functions to private participation. In this regard, it was felt that there has to be a proper assessment of the provisions of the Energy Act (and other related policy documents in Kenya) in order to understand if the policy environment was conducive to stimulate/facilitate entry of private players. If the case was not so, then a policy recommendation could emerge (provided that opening up the sector is found to be beneficial for the consumers and the economy).
- A suggestion was also to help the government review its policy in order to see how it could better attract private participation in the energy sector (especially in case of electricity). 'Market entry' conditions for private investors in the sub-sectors should be analysed.
- Taxation policy towards businesses in Kenya needed to be reviewed, in order to improve the enabling business environment.
- It would be useful for the study to look at the issue of *interface between competition and regulatory regime* especially relevant for the energy sector – by taking stock of 'good practices' from both developed and developing countries. It would help evolve some sort of an approach that would be relevant for Kenya – especially in line with the realization, worldwide, that the competition authority should develop a close cooperation arrangement with the sector regulators (in order to reduce friction).
- In the petroleum sector, in view of the recent restructuring etc. that has happened in the sector, it would be useful to calculate the individual market shares of the top 4 or 5 private players (i.e., compute CR4 or CR5[1] as is the case). It was informed that

[1] Concentration Ratio (for top 5 companies): calculated as the fraction of the turnover of an individual company over the total aggregate turnover of all the five companies put together.

the Monopolies and Prices Commission (Kenyan competition authority) had undertaken a recent study in the sector, which could be referred.

- There was some indication that there might be a cartel operating in the petroleum sector, as it has been seen that prices across companies follow a similar trajectory.
- It was felt by many participants[2] that there is a need for a strong advocacy campaign especially for the government to redress the state of consumers in the country. It was felt that Kenyan consumers have not been able to united and be organised to claim their rights (something that testifies the absence of a strong consumer movement in the country). A *watchdog* group should monitor prices of consumer goods.
- One possible approach to instilling competition in the electricity sub-sector was 'regionalisation of distribution'. Something that has been quite successful in South Africa (and also in India).
- Another approach would be to limit the time for each Power Purchase Agreement (PPAs) to 10-15 years, so that once the time limit is over, there is competition in the open market to win a subsequent PPA.

Session 11: Presention of the Methodology,
Presenter: Boaz Munga

Survey

The field survey will involve will be undertaken in the following levels:

- Key institutions/organizations which will include; Monopolies and Prices Commission, ERC, KenGen, IPPs, KPLC, Oil companies among others. The interviews will seek to assess the capacity of the institutions to deal with competition and regulatory issues, levels of complaints received the working relationship between the various players and get the opinions on improving competition and regulation.
- Key informants; industrial and consumer associations (e.g. KAM, KEPSA, CIN) NGOs, Research Institutions and other identified experts in energy issues. In this context, the questionnaires will target private sector associations, industrialists,NGOs among others. The questionnaires will seek expert's opinion on current regulatory and competition challenges facing the energy sector.
- General consumers of energy including households.

This questionnaire will target the consumers of energy at the household levels. The questions will seek to:

i. Obtain information on current competition and regulatory challenges facing the energy sector.
ii. Assess the knowledge on existing institutions to deal with competition and regulatory issues.
iii. Get recommendations and priorities.

[2] A total of 18 participants were there in this workshop

Methodology:

Methods

The assessment will be performed through a structured case study supplemented by cross-country analyses – with reference to best practice(s). Both primary and secondary data will be used and Methods of data collection will include: document reviews and consultative interviews (key informant interviews, and FGDs).

Data Collection Strategies & Sources

To ensure data representativeness, data will be gathered from both large & small market players and consumers. The various sources of primary data shall include: government ministries & agencies, research institutions, private sector bodies and consumer organizations.Secondary data sources will include: documents from the Ministry of Energy and other line ministries & agencies, Economic Surveys, Statistical Abstracts, and annual reports of the various market players.

Data Analysis and Reporting

Qualitative data will be analyzed using SWOT analysis, triangulation and thematic reviews. Quantitative data will be analyzed using appropriate statistical software. Data analyses will be summarized in tables with appropriate explanatory narratives.

Sample Design

The sample design shall be obtained from the following institutions

Key institutions and organizations – we shall perform a ***census.***

- Key informants – the study will employ ***judgment sampling***.
- General consumers –
  - Will be studied from a regional perspective.
  - Will be categorized as appropriate.
  - A reasonable quota will be picked form each category of consumers (i.e. ***quota sampling***).

Analytical Framework

The analytical framework for the study will be developed as follows:

- The core assumption is that there is neither a perfect regulatory system nor an ideal type of division of labour between competition authorities and other regulatory bodies.
- However**;** there are recognized basic principles of an appropriate or "good" regulatory system (and relationships between regulatory bodies and competition authorities).
- These principles include: independence, transparency, and investor and consumer protection (Levy and Spiller, 1993; UNCTAD, 2006; Brown et al, 2005).

- To carry out our evaluations/assessments of the regulatory system will make use of benchmarks for judging regulatory effectiveness as provided by Brown et al, 2005 and others.
- This study will make use of best practice independent regulator model (IRM) whose key characteristic is decision making independence.
- We have opted for the **IRM** because it approximates the current Kenyan setup. In addition, there is widespread empirical evidence that the model is associated with better sector outcomes. We shall evaluate the regulatory system against 10 key principles (and 15 critical standards) for the IRM. These principles include: independence; accountability; transparency and public participation; predictability; clarity of roles; and integrity.
- The evaluation of the **competition framework vis-à-vis other regulatory bodies** will also be guided by key principles as identified by UNCTAD (2006) which shall encompass the principles of subsidiary, transparency, due process, and proportionality.
- This analytical framework will be the basis of making generalizations and policy implications in the energy sector in Kenya.

Plenary Discussions and Summary of recommendations.

- It was felt that the analytical framework of the study was a little weak to be able to properly assess the 'impact of the regulatory framework', which was required from the perspective of good governance and consumer welfare.
- Also, the methodology needed to be further strengthened to be able to compute the 'distributional effects on differentiated consumers and users of electricity/energy in the country'.
- It seemed that the approach of using the IRM (Independent Regulator Model) to evolve the benchmarks for an appropriate regulatory framework in the energy sector was acceptable to the participants (especially the practitioners and scholars who were present). It was suggested that instead of using all the 15 critical standards of the IRM, it would be useful to pick up say about 6 of them that apply to 'good governance' (e.g., *independence, accountability, transparency and participation, predictability, clarity of roles and integrity*), and then split them in terms of <u>structure, conduct and performance</u>. It was further indicated that there has been much discourse of the issue of structure of regulators; so the emphasis for this study should be on conduct and performance.
- There was a suggestion from the floor that the study should try to touch upon the issue of 'political economy' issues/constraints in regulation (of electricity and petroleum sub-sectors).