

November 7, 2011

Comments from Netherlands on Kenya: Menengai Geothermal Development Project

Dear SREP colleagues,

On request of Ms Tineke Roholl, I herewith send you the comments of the Netherlands on the SREP investment project for the development of the Menengai geothermal field in Kenya.

With kind regards,

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Date 7 November 2011
Re SREP project appraisal "Menengai Geothermal Development Project"

Our reference
Ref 635-DME/KE

Comments of the Netherlands on SREP project Menengai - Kenya

Please find hereunder the comments of the Netherlands on the project appraisal document for the "Menengai Geothermal Development Project".

Background

The SREP Subcommittee met on November 2nd 2011 to discuss the acceptance of the 26 million Dollar investment in the Menengai Geothermal Development Project in Kenya.

At the inter-sessional virtual meeting of the SREP Subcommittee of September 8th, the Netherlands had shared its orientation that the proposed SREP activities in Kenya should find a realistic and reliable balance between public and private sector players and roles. Attention would be needed for the institutional risks in relation to the newly formed Geothermal Development Corporation, and experiences from private sector development should be used to the maximum.

From the project appraisal document, we did not see that these issues had been (sufficiently) addressed, and we would therefore like to share these as points of attention for the further development of the project.

Observation 1: Involvement of the private sector

The SREP investment plan for Kenya places the challenge of geothermal energy against the background of slow development and long delays in the past decades. From our partners at FMO we have learned that the more private-sector driven development of the Olkaria III geothermal field has been very satisfactory. In this case, the private sector took care of field development as well as power generation as Independent Power Producer (IPP). The project was also successful in terms of financing by attracting private sector finance to geothermal development in Kenya.

Against this setting, we would expect the Menengai field geothermal project to strike a balance between public sector supported field exploration and appraisal, and private sector based field development and power generation.

We would like to note that in the Netherlands the exploration and appraisal of geothermal wells is implemented by the private sector, supported by the public sector with through a risk guarantee arrangement.

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In the current proposal, GDC would be responsible not only for exploration and appraisal, but also development and operational management of the field. GDC would sell the steam to Kengen and possibly Independent Power Producers. This would be a maximum role for GDC as state owned organisation. We think that in the context of SREP's transformational objectives, it is important to pay more attention to how private sector capacity can best be mobilised and catalysed for these tasks.

We understand that work is on-going to better understand the technically optimal development approach for the Menengai field. Because this is highly relevant for the SREP supported project, we regret that the results could not have been integrated in the project proposal. Our suggestion would be to take the potential for private sector roles and involvement into account when assessing the results of this feasibility study.

Observation 2: Institutional capacity

The success of geothermal development in Kenya depends not only on the needed support by the public sector, but also on the capacity of the public sector organisations to deliver. In this project, the role of GDC is essential.

Against the background of past slow development of geothermal energy in the country, and understanding that GDC has been set up as special purpose vehicle with key staffing coming from the previous geothermal team in Kengen, we believe that the institutional risks related to the role of GDC need to be monitored and managed better. We fear that reconsidering tasks and roles of GDC may be a better risk management approach than more training and hiring more staff (as the proposal now mentions).

This would be clarified from the proposed business model and related risk assessment. We understand technical assistance is currently given to GDC to detail its business model and regret that the results have not been included in detail in the project proposal.

Observation 3: Corruption risk

In the same context of institutional risks, we would like to point to the management of corruption risks. In the October 2011 issue of The Nairobi Law Monthly, geothermal energy is presented as "the next frontier for kickbacks for Kenya's corrupt elite". In view of this worrying report, and the capital intensiveness of the sector, we believe that sector specific measures are needed to contain the corruption risk. We fear that a business model for IPPs to buy steam from GDC and sell power to KPLC may constitute a double risk.

We thank you for your kind consideration of the above.