

THE FUTURE OF ZAMBIA'S ENERGY SECTOR

Analysis of the
Energy and Electricity
Act, 2019 on the
Electricity Sub-sector

Part 1- Key Concepts

Client Alert

February 2020



Introduction

After almost a generation, the Energy Regulation Act Chapter 436 of the laws of Zambia (“Repealed Energy Act”) and the Electricity Act Chapter 433 of the laws of Zambia (“Repealed Electricity Act”) (“Repealed Acts”) are destined to be replaced with the Energy Regulation Act, 2019 (“Energy Act”) and Electricity Act, 2019 (“Electricity Act”) respectively. The Energy Act and the Electricity Act (“Acts”) will come into operation on the date appointed by the Minister by statutory instrument.

The Acts have retained the regulatory structure under which the Energy Regulation Board (“ERB”) and the Minister responsible for energy (“Minister”) are the key regulators for the energy sector **but with their functions redefined and expanded.**

Disclaimer
The content of this article is general in nature and not intended as a substitute for specific professional legal advice on any matter and should not be relied upon for that purpose.

The major reforms under the Acts appear to track the new energy policy which is more biased in terms of reform towards the electricity sub-sector. The Acts have followed the similar trend with the Repealed Acts not providing much coverage for the petroleum sub-sector. The Electricity Act, on the other hand, seeks to facilitate for a number of new approaches aimed at allocating some of the risk being taken up by ZESCO to other participants by shifting the sector from a single buyer market to a multi buyer market.

The electricity sub-sector has been dominated by ZESCO Limited a vertically integrated power utility which is responsible for generation, transmission, distribution and supply of

electricity in the country. A key consequence of this is the creation of a single buyer market where ZESCO in most cases is compelled to purchase power from all Independent Power Producers (“IPP’s”) or to import power where there is a deficit and thereby taking up the market risk of all the power produced or imported.

Due to the current challenges being faced by ZESCO, Government strategy for the electricity subsector appears to be underpinned by the need to shift the electricity market from a single buyer market to a multi buyer market, increase participants in the sector and ensure transparent allocation of all the risks, costs and revenues between participants of the

electricity sub-sector. Despite the foregoing, ZESCO is likely to remain a key player in the sector due to the existing asset ownership structure including existing Power Purchase Agreements (“PPA”) and Power Supply Agreements (“PSA”).

The Acts attempt to implement this strategy by providing for the following key concepts:

- (a) powers to regulate and approve tariffs;
- (b) prescription of minimum contents of bilateral agreements such as PPA and PSA;
- (c) providing for framework for setting up a spot market through the introduction of licensing framework for intermediary power trader to sit between producers and suppliers of power;
- (d) declaration of common carrier;
- (e) open access transmission regime on set terms and conditions and upon payment of user fee;
- (f) deregulation of importation and exportation of power in cases of emergency;

- (g) deregulation of importation and exportation of power through a competitive spot market;
- (h) multiyear tariffs;
- (i) minimum bilateral tariffs; and
- (j) direct dealings between supplier and offtakers.

This Article

This write up represents Part 1 of the Legal Alert which Corpus will issue in a series on the Acts.

Part 1 of the Legal Alert will focus on the key concepts introduced by the Acts, Part 2 of the Legal Alert to be issued later will focus on the effect of the new concepts on IPP’s, and thereafter Part 3 will focus on the implication of the new concepts on commercial and industrial users with bilateral agreements.

Lastly in the series, Part 4 will conclude with a focus on other market participants such as the intermediary trader, retail consumers, etc.

Government's strategy for the electricity subsector appears to be underpinned by the need to shift the electricity market from a single buyer market to a multi buyer market, increase participants in the sector and ensure transparent allocation of all the risks, costs and revenues between participants of the electricity sub-sector.

Key concepts introduced by the Acts

will positively transform the sector and create a key platform for the establishment of a competitive energy spot market.

Access to the Grid

To facilitate access to the national grid, which is required for an effective implementation of an intermediary power trader, the Electricity Act will require any person who seeks to access the grid to apply to the Transmission Network Service Provider (“TNSP”) or Distribution Network Service Provider (“DNSP”) and access will be granted on the conditions set out in the license of the TNSP or DNSP, which include among other things, the fees that may be charged by a TNSP or DNSP for the use of the transmission or distribution network.

The application for access must be approved within thirty days and any person aggrieved with the decision of the TNSP or DNSP or objects to the conditions imposed for access may appeal to the ERB. A key point from this is that the ERB will be required to specify the charges which a TNSP or DNSP may impose for use of the transmission or distribution network. Therefore, if this charge is made available public, it will allow for better planning by potential users of the system.

Provided ERB steps up its role as supreme gate keeper for sustaining access, this concept will allow players more predictability in identifying, measuring and managing this risk.

Import and Export of Power

The Electricity Act contains specific provisions on the importation and exportation of power in Zambia. The importation and exportation of power has been extended to both enterprises and consumers who wish to purchase or sell power outside Zambia to apply to the Minister for approval. The approval of the Minister, however, is not required where electricity is sold or purchased on a competitive spot market or is required for emergency purposes. This provision seeks to allocate and share some of the risk of purchasing power in cases of emergency to consumers who may require excess power which may not be available locally.

Similarly, producers with excess power should be able to navigate regulatory approvals where they are operating through a spot market or under an emergency. The dispensation of the approval requirements will result in the effective and efficient purchase of power in cases of market trade or emergency.

Regulators

The Acts retain the two-level regulation approach with the ERB effectively in charge of administering the sector while the Minister retains specified repository and supervisory powers. The current repository powers of the Minister, however, may create a perception of political interference in the operations of the ERB as the ERB is required to give effect to all the directives from the Minister. It would appear, nevertheless, that a directive from the Minister, which is outside the remit of, and is

inconsistent with, the provisions of the Acts can be challenged. The ability of the Minister to issue specific, rather than generic directions to the ERB is a key concern as the Minister can easily circumvent the role of the ERB contrary to best international regulatory practice.

Perhaps one of the main positive additions to the Acts which is in line with best international regulatory practice will be the introduction of a timeframe within which the ERB and Minister is required to consider and decide on the applications for a

licences. The ERB and Minister will be required to consider and determine an application within the prescribed time.

Intermediary Power Trader

The concept of an intermediary power trader which is not expressly provided for under the Repealed Acts is a key addition to the list of regulated participants and activities. An intermediary power trader has been introduced as a means of attracting IPP’s to develop projects with an option of relying on a creditworthy intermediary who will sit between producers and suppliers of power to manage some of the market risk. ZESCO, in this regard should not be expected to be the primary offtaker of all the power produced by IPP’s as a basis for a guaranteed market. It remains to be seen how this will work in practice although it is possible to contemplate how this concept

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Approval of Agreements

The ERB has express power to approve PPAs or PSAs for the local or export market. The Electricity Act, however, is silent on other agreements such as wheeling agreements or access agreements.

The Electricity Act also provides for some of the terms which should be inserted in the PPA or PSA which include quantity of the power, technical conditions, tariff and the tariff structure and any other term which the ERB may determine.

Bilateral Tariffs

A tariff is usually a key provision for the parties to the PPA and PSA and for purposes of certainty, it is usual for the tariff and tariff structure to have an adjustment index. The Electricity Act has included a dedicated part dealing with tariffs. The Electricity Act under this part makes a distinction between retail tariffs¹ and non-retail tariff (i.e. bilateral tariffs in a PPA or PSA).

However, notwithstanding what the parties would agree in the PSA or PPA, the Electricity Act allows the ERB to vary the bilateral tariff in the PSA or PPA by determining a minimum bilateral tariff either at the instance of the licensee or on its own motion. The determination is not expected to affect PPA's or PSA's with a tariff which is equal to or above the minimum bilateral tariff.

The prescription of a sector-wide minimum bilateral tariff could be a source of concern for parties to a PPA or PSA which is cost reflective from the unique economics of a projects or

¹ retail tariff" means the tariff at which the electric energy is sold to different customers but excludes bilateral tariffs in a power purchase agreement and power supply agreement;

relationship of the parties. This concern could be addressed by introducing a moratorium period under which the ERB should not interfere with the agreement of the parties as long as the PPA or PSA complies with the legal framework and existing policy (e.g. through the extension of multiyear tariff concept to PPAs and PSAs so that the integrity of a PPA or PSA could be secured for a predictable period notwithstanding the power of ERB to set a minimum tariff).

Further, the power to vary tariff by the ERB appears to be limited to PPA's and PSA's and does not extend to wheeling agreements. To ensure predictability in user fees for accessing the grid, it would have been ideal if the ERB could also prescribe the minimum wheeling or access fees for purposes of the Acts.

Declaration of Emergency

A licensee has power to apply to the ERB under the Electricity Act for a declaration that an emergency exists and if ERB determines that an emergency exists and is of a nature and extent that exceptional measures are necessary in the public interest, the ERB may declare an emergency. The declaration of an emergency entitles a licensee to submit a proposed tariff adjustment to the ERB for approval and in approving the tariff the ERB may dispense with the holding of a public hearing.

The expectation is that if a producer incurs additional costs in procuring additional power during an emergency, that cost should be shared with other participants through tariff revision. Consequently, the ERB may

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revoke its declaration if it considers that the emergency is no longer necessary, and the tariff approved during the emergency may cease to have effect.

While this provision maybe useful for some participants, it may be perceived as risky provision which could be abused and used as a means of increasing tariffs on the basis of an emergency by especially a public utility.

Dispute Resolution

As part of the dispute resolution mechanism, the Act has adopted the approach which recent statutes have taken or adopted, namely, the use of Tribunals. Consequently, a person aggrieved with any decision of the ERB may appeal to the Minister within thirty days of the decision and the Minister is required within seven days of the appeal to constitute an ad hoc appeals tribunal.

Further, a person aggrieved with the decision of the Tribunal may appeal to the High Court. For now, it is not clear how feasible it is to constitute an ad hoc tribunal within seven days considering the challenges with constituting Tribunals under similar provisions under the Securities Act, Information, Communication and Telecommunications Act, the Mines and Minerals Development Act, etc.

Concepts aimed at facilitating multi-buyer market

The concepts under the Acts explained above if implemented as intended may facilitate a shift to a multi-buyer market and facilitate the creation of a competitive spot market. The licensing regime has recognized new players in the market such as intermediary power trader who appear to be better placed to provide a producer with options for different credit worthy buyers in the market. This is complimented by open access provisions as a medium for the direct dealing between suppliers, offtakers, producers and network providers.

Ultimately, if the private sector could pick up substantial risk in the efficient and effective operation of the energy market this should reduce the cost of government involvement in sustaining the market and securing supply.

Further, with the relaxation of regulatory approvals in cases of emergency or where power is being purchased on a competitive spot market reinforces the intention of the policy makers to allow free trading of power among the different players.

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Conclusion

Although the new reforms under the Acts may not exactly amount to a complete overhaul of the Repealed Acts, the new concepts introduced by the Acts are expected to have significant positive and negative impact on the energy sector.

The introduction of an intermediary trader of power and power trading generally, timelines within which the ERB or Minister is required to act or issue a decision, deregulation of importation and exportation of power in cases of emergency or on a competitive spot market are positive development.

On the negative note, the increased regulatory powers of the ERB, to determine additional conditions to be attached to licences, regulate and approve agreements and determining minimum bilateral tariffs may have significant implication on participants in terms of predictability of regulation. Similarly, the power of the Minister to issue specific directions to ERB will be unusual and unnecessary where the sector is expected to be market driven and largely reliant on predictability.



Several provisions appear to provide for high level obligations with the expectation that the regulations and guidelines which may be issued by the Minister and the ERB will provide further details. In the absence of those regulations and guidelines any analysis of how certain provisions of the Acts will be operationalised remains speculative.



FOR MORE INFORMATION CONTACT:



Charles Mkokweza
Senior Partner

 +260 211 372300
 cmkokweza@corpus.co.zm



Joshua Mwamulima
Associate -Energy, Resources & Infrastructure

 +260 211 372300
 jmwamulima@corpus.co.zm

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