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Department:
Energy
REPUBLIC OF SOUTH AFRICA

Commission's Report relating to the market enquiry into the Liquefied Petroleum Gas Sector

Presentation to the Portfolio Committee on Energy

05 September 2017



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Presentation Outline

- Introduction
- Purpose of the Market Inquiry into the LPG Sector
- Findings and Recommendations of the Competition Commission
- Response to Recommendations by DOE
- Conclusion

Introduction

- The Competition Commission initiated a market inquiry into the Liquefied Petroleum Gas (LPG) sector in South Africa and concluded its investigation on 31 March 2017.
- Before the report was finalised, the Department of Energy was consulted on key recommendations and the process that will be followed in publishing the report in the Government Gazette.

Introduction (cont..)

- The Department:
 - Fully supports the objectives of the market Inquiry as it's a global practice undertaken by competition authorities to understand the market dynamics of complex sectors and assess market distortions impeding competition; and
 - Commits to within its sphere of influence implement some of the proposed recommendations, particularly those relating to overlapping and misaligned regulatory environment as well as periodically review the progress thereof.

Purpose of the Market Inquiry

- In terms of the Competition Act of 1998, the purpose of a market inquiry is a general investigation into the nature and form of competition of an industry and not an investigation of anti-competitive behaviour.
- The Market Inquiry into the LPG Sector was the first ever inquiry conducted by the Competition Commission.
- It was initiated in August 2014 and the Report was published in March 2017.
- The Competition Commission can only make recommendations for the LPG Sector which are not binding however should be considered by the responsible Department.

Findings and Recommendations of the Competition Commission

1. The Market Structure - Concentration and Ownership

Finding: The market is highly concentrated

- At refinery level, only 5 refineries currently producing LPG.
- At wholesale level, only four large wholesalers resulting in barriers to entry from smaller wholesalers.

Commission's Recommendation

- Commission to monitor this market as the structure is conducive for collusive behaviour.

Findings and Recommendations of the Competition Commission

2. Regulatory Environment: Non- Price

Finding: Overlap and misalignments in the mandates of National Energy Regulator South Africa (NERSA) and Transnet National Ports Authority (TNPA) which delay infrastructure investments.

Commission's Recommendations

- NERSA and TNPA adjudication process should be aligned and there should also be sequencing of legal processes.
- NERSA must be the regulator responsible for issuing wholesale licensing and monitoring thereof.

Findings and Recommendations of the Competition Commission

3. Regulatory Environment: Pricing

Findings

- Maximum Refinery Gate Price (MRGP) and Maximum Retail Price (MRP) have not been reviewed by DOE.
- No effective monitoring and enforcement of regulated prices MRGP and MRP.
- Pricing methodology uses Petrol 93 as a proxy for LPG pricing.
- Lack of incentives by refineries through MRGP.
- Unavailability of imported products due to logistics.

Findings and Recommendations of the Competition Commission

3. Regulatory Environment: Pricing

Commission's Recommendations

- Prioritise import efficiency and optimisation to ensure importation of large parcels of LPG.
- NERSA must undertake pricing and the monitoring of MRGP and MRP.
- DoE to conduct a study on price deregulation once import facilities come on stream.

Findings and Recommendations of the Competition Commission

4. Limited Domestic Supply

Finding

- Limited production of LPG by local refineries due to NERSA and TNPA overlapping mandates
- Results in inadequate import infrastructure.

Commission's Recommendation

- A review of the regulatory frameworks applicable to the construction of LPG import and storage facilities at ports as outlined in legislation, including the Petroleum Pipelines Act and National Ports Act.

Findings and Recommendations of the Competition Commission

5. Long term supply agreements

Finding

- Long term supply agreements with bigger players (25 years) and discounts of about (10%) from MRGP
- These agreements prohibit smaller players from competing and result in lack of Economies of Scale. They rely on spot market prices

Findings and Recommendations of the Competition Commission

5. Long term supply agreements

Commission's Recommendations

- Smaller wholesalers must get preferential access to 10% of LPG volume.
- Contracts to be limited to 10 years and all automatic renewal clauses to be abolished.

Findings and Recommendations of the Competition Commission

6. Coordinated Behaviour

Finding

- Cylinder deposit fees have not been reviewed by DoE.
- The commission believes that there is collusion with respect to cylinder deposits.

Commission's Recommendations

- NERSA, rather than DoE, should be responsible for the determination of the deposit fees and the subsequent annual reviews.
- DOE to amend MRP working rules to enable NERSA to undertake

this task

Findings and Recommendations of the Competition Commission

7. Sale of LPG through cylinders

Finding

- The cylinder exchange practice is a barrier to entry due to bilateral agreements which affect participation of other parties.

Commission's Recommendation

- The cylinder exchange practice should be more inclusive
- No wholesaler should unreasonably be denied to enter into bilateral arrangements to facilitate cylinder exchange.

Findings and Recommendations of the Competition Commission

7. High costs of switching for bulk LPG

Findings

- Reluctance of current wholesalers to sell equipment to incoming wholesalers due to different evaluation methodologies.
- Bulk supply agreements are structured in a vague manner.

Findings and Recommendations of the Competition Commission

7. High costs of switching for bulk LPG

Commission's Recommendations

- Separation of LPG supply agreements from LPG equipment agreements
- NERSA's mandate expanded to include dispute resolution relating to interpretation and application of valuation methodology of LPG equipment.
- NERSA to develop and publish a bulk LPG equipment installation valuation methodology and also adjudicate on disputes in the valuation of bulk equipment and installations leading to switching impediments.

DoE Response to Recommendations

1. Concentration and Ownership

View of the DOE

- The DOE supports the recommendation by the Commission to monitor the market structure for collusive behaviour.

DoE Response to Recommendations

2. Regulatory Environment: Non- Pricing

Views of the DoE on NERSA being the Regulator responsible for issuing wholesale licensing and monitoring thereof:

- NERSA as an economic regulator has a mandate to issue licenses for the construction and operation of petroleum loading facilities and pipelines.
- Does not have authority to issue licences for facilities used in the manufacturing of petroleum products. Only the Minister of Energy has the authority to do so under the Petroleum Products Act

DoE Response to Recommendations

2. Regulatory Environment: Non- Pricing

Views of the DoE on NERSA and TNPA adjudication processes

- DoE acknowledges the challenges created by the overlapping of the jurisdictions of the National Energy Regulator of South Africa (“NERSA”) and Transnet National Ports Authority (“TNPA”), regarding approvals for the construction of import and storage facilities at the ports.
- DoE agrees with the Competition Commission that there should be alignment of the regulatory processes.

DoE Response to Recommendations

2. Regulatory Environment: Non- Pricing

Views of the DoE on NERSA and TNPA adjudication processes (cont..)

- There is an MOU between NERSA and TNPA to deal with the overlaps and misalignment in their regulatory mandates.
- Process likely to unearth solutions for other challenges such as the interpretation of section 56 of the Ports Act and what it empowers TNPA to do.

DoE Response to Recommendations

3. Regulatory Environment: Pricing

Views of the DoE on NERSA having to undertake pricing and the monitoring of MRGP and MRP.

- NERSA is an economic regulator with the mandate to regulate petroleum infrastructure in terms of the Petroleum Products Pipelines Act.
- The DoE is empowered to regulate prices of petroleum products such as LPG in terms of the Petroleum Products Act.
- DoE's view is that focus should be on reviewing and correcting the pricing framework rather than shifting regulation.

DoE Response to Recommendations

3. Regulatory Environment: Pricing

Views of the DOE on NERSA having to undertake pricing and the monitoring of MRGP and MRP (cont...)

- The DoE is in the process of developing a clear pricing framework to review the MRGP and MRP (and working rules) during this financial year.
- A mechanism of monitoring compliance of other suppliers (e.g. hardware stores) would need to be developed by the DOE.
- The DoE, in the short-term, agrees that there needs to be significant punitive measures put in place to act as deterrent against non-

DoE Response to Recommendations

3. Regulatory Environment: Pricing

Views of the DOE on NERSA having to undertake pricing and the monitoring of MRGP and MRP (cont.)

- To this end, the DoE would be amending the Petroleum Products Act to deal with amongst other things, penalties for non-compliance.
- The Energy White Paper of 1998 prescribes a move towards deregulation. Currently, all barriers and issues relating to pricing should be dealt with before deregulation is considered.
- This will be considered in the amendment of the Petroleum Products Act.

DoE Response to Recommendations

4. Limited Domestic Supply

DoE view on Limited Domestic Supply

- The main obstacle in the usage of LPG by household consumers is the inadequate supply due to limited local production and inadequate import infrastructure .
- LPG is not the core product of refining companies. The latter produce LPG mostly for own use in the refining process and whatever is left is for contracted big customers.

DoE Response to Recommendations

4. Limited Domestic Supply

DoE view on Limited Domestic Supply (cont..)

- Demand for household consumers is mainly satisfied from imported LPG by wholesalers.
- Construction of import facilities is essential for provision of adequate supplies.
- There is an MOU between NERSA and TNPA to deal with the overlaps and misalignment in their regulatory mandates.
- DoE to engage the Department of Transport to determine if the ultimate solution would require an amendment of legislation.

DoE Response to Recommendations

4. Limited Domestic Supply

DoE view on Limited Domestic Supply (cont..)

- It is the Department's objective to move to price deregulation in the long-term once there is adequate supply.
- This will even make LPG more accessible in terms of price.

DoE Response to Recommendations

5. Long Term Supply Agreements

Views of the DoE

- Long term contractual agreements and automatic renewal clauses are valid concerns and should be addressed. The DoE supports the Commission's view. The Commission is well placed to deal with such uncompetitive behaviour.
- With regards to the issue of preferential access of 10% for smaller wholesalers and limiting agreements to 10 years, the playing field must be level for all wholesalers to compete on equal footing. The DoE is in agreement with this view.

DoE Response to Recommendations

5. Long Term Supply Agreements

Views of the DoE

- Infrastructure must be delinked from the contractual agreements once the facility is amortized so that any wholesaler can participate in the supply chain.

DoE Response to Recommendations

6. Coordinated Behaviour

View of the DoE

- Cylinders are a necessary investment used to reach the market and compete effectively in this sector.
- Consequently, wholesalers have invested in the cylinder market to ensure that their stock of cylinders is sufficient to meet market demand.
- Protection through cylinder deposits is crucial. Such deposits need to be affordable to encourage usage of LPG by potential customers.

DoE Response to Recommendations

6. Coordinated Behaviour

View of the DOE (cont...)

- A policy position on cylinder deposit fees will be developed by the DOE.
- The policy to take into consideration that LPG prices in South Africa are higher than in most countries.

DoE Response to Recommendations

7. Sale of LPG through cylinders

View of the DoE

- The cylinder exchange practice should be investigated in detail by the Commission in conjunction with the Department of Labour.
- In particular, the bilateral agreements that seem to prohibit entrant into the market by new players.

DoE Response to Recommendations

8. High costs of switching for bulk LPG

View of the DoE

- The DOE's reticulation of LPG including reticulation at shopping centres and residential areas are specifically excluded from Nersa's mandate. This will be reviewed.
- The DoE supports the recommendation made by market participants that major auditing firms or the Arbitration Foundation of South Africa or the alternate Dispute Resolution Association of South Africa are appropriate independent bodies to handle disputes.

DoE Response to Recommendations

8. High costs of switching for bulk LPG

View of the DOE (cont..)

- With respect to bulk LPG agreements that tie down the distributor to a specific supplier because the storage facilities belong to the supplier, the DOE's view is that the facility should be delinked once it is amortized.

Conclusion

- The DoE believes that a regulated price is effective and efficient if the wholesale value chain is regulated.
- The DoE is in the process of revising the pricing mechanism throughout the value chain.
- The Department supports the Competition Commission's view that it should start considering de-regulation of LPG pricing
- This will happen when the country has abundant supplies of LPG and more players competing in the market place.

Conclusion (cont..)

- There is a need for adequate import and storage facilities which will allow for the importation of LPG economical cargo parcels.
- To this end, the Department has since made some enabling amendments to Regulations pertaining to petroleum infrastructure investments.
- Two LPG import terminal facilities have recently been commissioned in Saldanha, Western Cape. These facilities have doubled the import capacity and will open up the LPG market in the country.
- The Minister visited both facilities in July 2017.
- Two more facilities have been licensed by NERSA in Coega and Richards Bay.



Thank you