



***competition*commission**  
***south africa***

**LIQUEFIED PETROLEUM GAS (“LPG”) MARKET INQUIRY**

**REQUEST FOR COMMENTS FROM ALL STAKEHOLDERS ON PROPOSED REMEDIES  
AND RECOMMENDATIONS**

**May 2016**

## 1. Introduction

- 1.1. The Competition Commission (“Commission”) commenced an inquiry into the LPG sector (“the LPG market inquiry”) in terms of Chapter 4A of the Competition Act, 89 of 1998, as amended (“the Act”) on 15 September 2014 as it had reason to believe that there are features of the sector that prevent, distort or restrict competition.
- 1.2. The Terms of Reference (“ToR”) of the LPG market inquiry were published in the *Government Gazette No.37903* on 15 August 2014 and identified the following broad themes as the rationale for initiating the LPG market inquiry:
  - 1.2.1. Structural features of the market;
  - 1.2.2. High switching costs;
  - 1.2.3. Regulatory environment and its impact on competition; and
  - 1.2.4. Limited usage of LPG at the household level.
- 1.3. The Commission engaged with stakeholders through an initial call for submissions, targeted information requests, meetings and site visits.
- 1.4. In addition to the above, a call for further submissions on 27 August 2015 was published. The purpose was to solicit additional views on narrow issues highlighted by the market participants. The issues raised by market participants which necessitated the call for further submissions related to: preferential supply allocation; bulk end-users’ limitations to switch; LPG cylinder exchange programme challenges; limited LPG import facilities and regulatory challenges.

## 2. Purpose

- 2.1. This note outlines some of the findings and recommendations emerging from the LPG market inquiry. Accordingly, the Commission hereby requests all stakeholders including market participants to provide further submissions<sup>1</sup> in respect of the recommendations.
- 2.2. Kindly note that the findings presented below are not exhaustive. These are the findings in which the Commission requests further submissions from all stakeholders on the proposed recommendations.

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<sup>1</sup> Submissions may include but are not limited to providing further clarity; supporting evidence; or suggestions and recommendations on how to deal with the issues identified to promote healthy competition in the LPG market.

- 2.3. Submissions should focus on the actions which market participants consider might be taken, or recommended for implementation, for the purpose of remedying, mitigating or preventing the concerns identified.
- 2.4. Specifically, market participants should provide their views on the recommendations and on how the recommendations can be implemented and which entity (where possible) would be best placed to implement such recommendations. Apart from the suggested recommendations, market participants are encouraged to propose additional recommendations to remedy some of the concerns identified.
- 2.5. Submissions should be as detailed as possible and any views or opinions expressed should be substantiated, as far as possible, by evidence or by practise from other jurisdictions.
- 2.6. No significance should be attached to the ordering of the measures set out below.
- 2.7. Submissions should be emailed to [lpg@compcom.co.za](mailto:lpg@compcom.co.za) by **07 June 2016**.

## **Preliminary Findings and Recommendation**

### **3. On the long-term supply agreements offered by refineries**

- 3.1. The Commission has found that refineries tend to prefer long-term supply agreements due to, *inter alia*, commercial considerations such as the reliability of volume upliftment, established credit and payment history. The Commission also found that the ability to secure supply of LPG from refineries is a significant barrier to entry for wholesalers. As such, the Commission is of the view that the wholesalers with long-term contractual agreements are granted a competitive advantage over other wholesalers. In particular, the ability of competitors to enter and/or expand at the wholesale level may be affected negatively due to foreclosure of supply. These effects may also be exacerbated by the frequent occurrence of product shortage. The Commission's investigation has revealed that the historical vertical integration between LPG producers and certain wholesalers has perpetuated such long term agreements.
- 3.2. Further, the Commission has found that the allocation of LPG from the majority of refineries is in the following order: (i) internal consumption to satisfy the refineries' own operational needs. This ranged from 30% to 70% of total LPG production for some refineries; (ii) contractual obligations. This accounted for at least 80% of the LPG available to the market; and (iii) spot sales. The share of spot sales as a

percentage proportion of total LPG sales in the market has been declining from 22% in 2010 to at least 15% in 2014.

3.3. The Commission analysed a number of long-term supply agreements that are in place between the refineries and wholesalers and found the following:

3.3.1. In terms of the *duration of the contracts*, the Commission found that some agreements have been renewed with the same wholesaler for over 25 years. Further, the Commission found evidence of contracts including unlimited renewal clauses which have the effect of making the contracts “evergreen contracts” which entrenches incumbency advantages of large wholesalers.

3.3.2. With regards to the *effect of long term agreements on pricing*, some long term supply agreements made provisions for discounts off the Maximum Refinery Gate Price (“MRGP”). It was found that the discounts offered can go up to 10% off the MRGP. Moreover, small wholesalers – whether in a supply agreement or not – do not benefit from any significant price discounts. Despite the declining volumes available on the spot market and with no discount on MRGP, the smaller wholesalers have been pricing competitively against the more established larger wholesalers.

3.4. Based on these observations, the Commission is of the view that long-term supply agreements offered by the refineries to large wholesalers have conferred some degree of competitive advantage to these wholesalers. The Commission is also of the view that given that these long-term supply agreements are offered on a preferential basis, this has allowed for the major/large wholesalers to maintain their positions in the market regardless of the entry which has occurred. Lastly, the Commission is of the view that the effect of these agreements constrains the smaller wholesalers’ ability to compete effectively in the market due to limited supply in the spot market.

3.5. The competitive ability of a wholesaler (whether large or small) is strictly dependent on being able to obtain sufficient and consistent supply of LPG. Accordingly, the Commission believes that the market is likely to be more competitive if smaller wholesalers are able to secure sufficient volumes of LPG on a consistent basis. This has been clearly demonstrated by the price competitiveness of the smaller wholesalers who have been able to secure LPG volumes.

### *Proposed recommendations*

- 3.6. Based on the above, the Commission proposes either or a combination of the following:
- 3.6.1. A decrease in the duration of the supply agreements entered into by refineries and wholesalers to provide an opportunity for other wholesalers to be able compete for LPG supply;
  - 3.6.2. Alternatively, a cancellation of automatic renewal clauses in the supply agreements;
  - 3.6.3. A new allocation mechanism to be put in place wherein all wholesalers would bid for their required LPG volumes from all refineries. This bidding market would allow for all wholesalers to receive LPG volumes on a fair and non-discriminatory basis; and
  - 3.6.4. A minimum percentage to be allocated to small wholesalers by each refinery.

#### **4. On the high costs of switching**

- 4.1. The Commission has found that switching<sup>2</sup>, at the bulk LPG segment of the market, does take place but it does not occur seamlessly.<sup>3</sup> The ease of switching was found to depend on the costs likely to be incurred by the end-user due to the possible disruption in supply caused by the incumbent supplier either selling or removing their LPG equipment. Common reasons cited for not switching included (i) the end-users' ability to renegotiate their supply contract on more favourable terms (such as lower pricing), or (ii) circumstances where the cost to switch suppliers outweighed any savings the end-user would derive from switching.
- 4.2. The ability of an end-user to switch LPG suppliers (in response to a more competitive price offer for example) in a seamless manner was of interest due to previous complaints received by the Commission. The Commission found anecdotal evidence indicating that the decision to switch LPG suppliers was no longer based on pure price and volume considerations but was compounded with considerations related to the recovery cost of the installed LPG equipment which would have to be removed when changing suppliers.

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<sup>2</sup> Switching is defined as the situation where an end-user consuming LPG in either bulk or cylinder manifold chooses to find an alternative supplier

<sup>3</sup> The Commission did not consider the switching experience for cylinder end-users given the relative ease of switching in this segment of the market.

- 4.3. The Commission's investigation found that the extent to which switching may be problematic for bulk end-users takes into account the following: (i) the substantial capital investment required in the installation of LPG bulk and cylinder manifolds, (ii) the ownership of equipment usually remains with the party that provides the capital outlay (typically the LPG supplier and not the end-user), (iii) safety considerations and regulations, and (iv) the existence of highly restrictive supply contracts between LPG wholesalers and end-users.
- 4.4. In instances where end-users were able to switch, the Commission found that this did not occur seamlessly. Specifically, the following emerged:
- 4.4.1. Suppliers are sometimes unable to reach agreement on the valuation of the LPG equipment to allow for a transfer in ownership of the installed LPG equipment;
  - 4.4.2. End-users face a potential disruption in supply while the incumbent supplier removes its equipment to allow for the incoming supplier to install its own equipment;
  - 4.4.3. Environmental Impact Assessment ("EIA") restrictions<sup>4</sup> also exacerbate the issues associated with switching. The EIA assessment is triggered when the total storage capacity of LPG on the end-user's site increased by more than 80m<sup>2</sup>. This is important because under circumstances where the incumbent supplier refuses to move their equipment or delays the removal of their equipment, the incoming supplier may be unable to ensure no disruptions in supply to the end-user if the storage capacity will exceed 80m<sup>2</sup>;
  - 4.4.4. Contracts entered into by end-users with LPG suppliers may contain clauses that further restrict the end-user's ability to switch LPG suppliers. A review of the majority of the contracts found the following:
    - 4.4.4.1. In some instances, provisions allowing the incumbent first right of refusal for the sale of its equipment are included; and
    - 4.4.4.2. A provision restricting the incoming supplier from installing its equipment until the incumbent supplier has decommissioned its own equipment.

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<sup>4</sup> This is a technical tool that identifies, predicts and analyses impacts on the physical environment as well as social and health impact and takes approximately 9 month to complete. This is conducted by the Department of Environmental Affairs.

### *Features of the supply agreements entered into by the end-users*

- 4.5. The Commission analysed the terms and conditions included in the supply agreements entered into by LPG suppliers and end-users. The Commission is of the opinion that these supply agreements are structured in a vague manner with respect to the terms and conditions related to the early termination of the supply agreement. In particular, the Commission found evidence of termination clauses outlining that for an end-user to terminate their agreement prior to the contracted period, end-users are not only expected to pay for the remainder of the capital cost<sup>5</sup> but are also expected to pay for the removal and installation of the relevant LPG equipment. The Commission is of the opinion that such clauses are prohibitive as they act to increase the costs associated with switching.
- 4.6. Further, the Commission noted that in most instances, these supply agreements are entered into for a minimum period of 5 years with a renewal clause included. In some of the supply agreements, the Commission found that if there was any work or alteration done to LPG equipment by the wholesaler at any point during the initial period of the supply agreement, the contract duration would then be extended. The duration of the contract extension is based on the time that has lapsed from when the contract was initiated to the point in time when the alteration was done.<sup>6</sup> This clause was found to apply to all alterations conducted (regardless of the cost or significance of the alternation). The Commission is of the opinion that this provides scope for suppliers to unjustifiably alter equipment at their discretion attributing such alterations to changes in regulations or technological advancements.
- 4.7. The Commission has also noted that the manner in which most of the bulk LPG supply agreements are structured is vague with respect to equipment ownership<sup>7</sup> during and after the expiration of the initial supply agreement. In particular, the Commission found that there is limited disclosure on when the costs of the installed LPG equipment will be fully amortised and whether the end-users will be in a position to own the installed equipment at some point in time. Moreover, an examination of the supply agreements revealed that in the majority of cases, equipment ownership lies with the wholesale supplier and that equipment ownership is not transferred to the bulk end user at the end of the term.

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<sup>5</sup> The Commission notes that there are instances where end-users have been requested to pay the total capital cost (that is, pay an amount not only limited to what is remaining in the contract).

<sup>6</sup> For example, if the alteration occurred at Year 2 of the five year contract, the end-user's contract would be extended by an additional two years (which would make the supply agreement effective for seven years in total).

<sup>7</sup> The equipment referred to above includes bulk tank and the reticulation system.

- 4.8. The Commission also found that the determination of the price to be charged for the supply of LPG includes cost items not directly related to the amount of LPG used by the end-user. Further, it is unclear what portion of the final price charged is based on the additional cost items (such as the costs associated with the maintenance and installation of equipment) as compared to the amount of LPG used. The Commission is of the view that the limited disclosure of the true price determination contributes to end-users being unable to successfully switch LPG suppliers as they are unable to make a comparison of the suppliers based on price.
- 4.9. Further, an examination of the supply agreements entered into by the tenants and landlords/property developers at shopping centres revealed that these supply agreements are equally structured in a vague manner. The following salient features were of particular concern to the Commission:
- 4.9.1. Ownership of the installed reticulation system rests with the supplier even in instances where the property owner has fully amortised the cost of the installation;
- 4.9.2. The LPG supplier signs an initial contract with the landlord to install and operate the equipment at the shopping centre. Subsequent to this, the LPG supplier enters into another contract with each of the tenants at the shopping centre for the supply of LPG. Given that contracts are entered into at different times between tenants, on the one hand, and the shopping centre, on the other, contracts tend to be staggered. By this we mean that the contractual period entered into by the landlord and the supplier generally differs from the stipulated period signed into between the tenant and the supplier. This means that in the event where the tenants may wish to switch suppliers, if their termination period is not in line with the landlord's contract then they will be unable to switch.
- 4.9.3. Importantly, the Commission found evidence of some supply agreements including clauses that outline that wholesalers pay landlords a monthly rental fee/commission commensurate with the volume of LPG consumed by the tenants or as a percentage of the invoiced amount. The Commission is of the opinion that the use of these incentive measures may be construed to provide perverse incentives to landlords to ensure continued use of a certain wholesaler's LPG and hence inhibit the ability of the shopping centre to switch LPG suppliers even if the tenants are to identify a supplier with a competitive price.

- 4.10. The Commission is of the view that the limited disclosure of these salient features of the supply agreements creates an environment wherein end-users are unable to switch effortlessly at the end of a contractual period due to the fact that the installed equipment is either not fully amortised or ownership of the equipment remains with the supplier (regardless of the full amortisation of the equipment).
- 4.11. As such, the Commission is of the view that the equipment and supply of LPG should be subjected to different contractual agreements to ensure transparency and facilitate the switching of LPG suppliers.

*Proposed recommendations*

- 4.12. To improve transparency and full disclosure of equipment costs and the price of bulk LPG, the Commission is recommending the separation of agreements entered into between the end-user and LPG supplier. The first agreement would pertain to the cost and usage of the installed LPG equipment and the second agreement would pertain to supply of LPG.
- 4.12.1. With regards to the agreement pertaining to the cost and usage of LPG equipment, the Commission proposes that an end-user should be in a position to own the installed equipment after the costs are fully amortised.
- 4.13. In order to ease the hurdles associated with switching, the Commission is proposing the establishment of a dispute resolution mechanism (if parties do not agree on commercial terms related to the sale of the equipment) to allow for the transfer of ownership of the LPG equipment between the incumbent supplier and the incoming LPG supplier. This dispute resolution mechanism would standardise the process to be followed if the LPG suppliers do not agree on the valuation of the equipment. This dispute mechanism should have the following contractual principles:
- 4.13.1. Customers, by default, should have provisions for tank transfer in their contractual agreements with wholesalers with clear methodology on how the equipment should be valued;
- 4.13.2. Incoming suppliers to have a right, subject to a commercially agreeable arrangement, to buy the existing tank and piping equipment from the outgoing supplier. The incoming supplier will have two options, firstly to negotiate with incumbent for the transfer of the equipment or secondly take over the equipment based on the existing terms between the customer and incumbent

supplier. The outgoing supplier will have an obligation to sell the equipment at a price determined by the appropriate methodology; and

4.13.3. Customers should be provided with information on how to switch in their contracts - this information should be clearly explained prior to signing the contract and a legal declaration should be signed by both parties to ensure that this discussion did take place. It is recommended that this legal declaration should be signed in all future supply agreements and should be added as an addendum to the supply agreements already in existence.

4.14. The Commission is therefore requesting further comments and proposals on the proposed recommendations, particularly the following:

4.14.1. Equipment valuation methodologies (with clearly defined variables in the formula) to ensure that the proposal is implementable.

4.14.2. Which body/entity<sup>8</sup> (either existing or new) that would facilitate the dispute resolution mechanism (e.g. any relevant body that existing wholesalers are or not part of). The proposals should highlight the following among others:

4.14.2.1. The technical skills required (engineers, etc.) to conduct this assessment;

4.14.2.2. The funding of such an entity; and

4.14.2.3. Who bears the costs e.g. does the incoming and outgoing supplier share the costs in instances of dispute – this is an important consideration to avoid unnecessary time delays.

## **5. On the sale of LPG through cylinders**

5.1. The Commission has learnt that the sale of LPG through cylinders is considered to be a necessary route to market to compete effectively in this industry. Further, cylinders are considered to be particularly important for increased LPG usage amongst residential end-users and small- or medium enterprises that have built businesses supplying and/or distributing LPG to residential end-users.

5.2. The Commission initiated a cartel investigation into the sale of LPG through cylinders and conducted a dawn raid at the offices of several wholesalers alleged to be part of the cartel conduct. As such, the competitive dynamics surrounding the sale of LPG through cylinders are of particular interest. The Commission investigated (i) the

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<sup>8</sup> Establishment of the legal powers of such an entity will be dealt with at a later stage.

effects of the cylinder exchange practice and (ii) the allegations received regarding the cross filling of cylinders, and the effect this has on competition.

*On the cylinder exchange practice*

- 5.3. The cylinder exchange practice, currently in place, describes the practice amongst cylinder wholesalers/resellers and distributors through which empty cylinders are exchanged between or returned to owners. Cylinders are exchanged either on a one-to-one (1:1) basis or, if the number of empty cylinders exchanged is not equal, the recipient with the greater number of cylinders will pay the deposit value on each of the additional cylinders received. The deposit fee paid on each empty cylinder recently increased from R150 to R300 excluding VAT.
- 5.4. The Commission found that there are some advantages associated with the cylinder exchange practice<sup>9</sup> especially for households and end-users. For wholesalers, the cylinder exchange mechanism is aimed at making it easier and quicker for retrieving cylinders, by swapping each other's cylinders, as it minimises transport costs.
- 5.5. The Commission is of the view that even though there are these advantages, the practice may lead to anti-competitive behaviour. Specifically, the Commission is concerned with the frequent interaction between wholesalers/ that is facilitated by this practice.
- 5.6. Further, the Commission is of the view that the cylinder exchange practice is open for abuse by competitors and the impact is severe especially for smaller players with fewer cylinders. This is due to the alleged conduct by some wholesalers where cylinders are moved out of their operational area and in some instances moved out of South Africa. This will limit the number of cylinders available for that particular wholesaler which impact on its ability to service its clients and ultimately impact its competitiveness.

*On the cross-filling of LPG cylinders*

- 5.7. The Commission has learnt of instances of cross-filling<sup>10</sup> of cylinders. The Commission has found that cross-filling is a prevailing practice in the industry and

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<sup>9</sup> When the consumer's cylinder is empty, they can swap it for a full cylinder at the relevant LPG supplier for any other brand

<sup>10</sup> This refers to a situation wherein an industry player refills a branded cylinder belonging to another wholesaler.

occurs through either legal<sup>11</sup> or illegal means. Safety has been noted as a key concern related to the illegal filling of cylinders. This notwithstanding, the Commission found that the safety checks/assessments and inspection conducted by the wholesalers in the process of filling are relatively standard across the wholesalers and may be conducted with relative ease. The level of training required for cylinder fillers is basic and can be done by wholesalers themselves or outsourced to third parties. Accordingly, it appears that with adherence to safety protocols and the related compliance monitoring mechanisms, cross-filling can take place and thus minimise the need for the cylinder exchange practice in the industry.

*Proposed recommendations*

5.8. Based on the concerns identified above, the Commission recommends the following :

5.8.1. The cylinder exchange practice among wholesalers (in its current form) should be abolished to eliminate the frequent direct interaction amongst wholesalers.

5.8.2. Based on the evidence of cross-filling behaviour in the industry (specifically that which has been conducted in compliance with the safety standards as prescribed by regulations), the Commission is of the view that customers should be able to fill LPG at accredited LPG filling sites. The Commission acknowledges that currently, the filling sites of LPG may not be sufficient to allow for an increase in LPG usage amongst users. As such, the expansion of third-party operated and managed cylinder filling sites at the retail level should be considered where the retail outlets will be provided with required training for cylinder inspection, filling and handling. The responsibility of training and safety standards will rest with the retailers with the assistance of respective LPG suppliers. In particular, the Commission recommends the following:

5.8.2.1. A database of all accredited LPG fillers should be created wherein the accredited fillers would receive a unique number to ensure that they are registered to operate as a competent filler by the Department of Labour (“DoL”); and

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<sup>11</sup> Cross-filling, in the current legislative framework, is legal if permission is granted by another wholesaler to fill its cylinders. The Commission has noted instances where cross-filling is done for a fee and most of the instances have been noted amongst established players.

- 5.8.2.2. All accredited fillers should be provided with a unique seal (where their registration number will be clearly visible) that will ensure that fillers are easily identifiable to DoL inspectors in the event of an accident.
- 5.8.3. The Commission recommends that Section 10(4) of the Occupational Health and Safety Act (“OHSA”) be amended to remove the requirement for written consent before cross-filling can take place. In this proposal, the safety responsibility would now shift to the filler (who will be required to have registered seals) and not necessarily the cylinder owner.
- 5.8.4. In order to foster competition, the Commission is of the view that in the long-term customers should own their own cylinders (and voluntarily exchange cylinders) and fill at any accredited filling site. The responsibility for cylinder inspection before filling will rest with the retailer<sup>12</sup>.

## **6. On the regulatory environment and limited domestic supply**

6.1. The Commission is of the view that there is a need for measures to be implemented aimed at improving the regulatory environment in which the LPG industry operates in. The Commission has found that there are significant bottlenecks in the regulatory environment which may hinder the ability of potential competitors to enter and/or expand in the LPG industry. These bottlenecks are discussed below:

### **(i) On import and storage facilities**

- 6.2. The Commission is of the view that there are significant bottlenecks caused by the overlapping jurisdiction between the National Energy Regulator of South Africa (“NERSA”) and the Transnet National Ports Authority (“TNPA”) in relation to approvals for the construction of import and storage facilities at the ports.
- 6.3. In terms of the Ports Act, the Commission has learnt that the TNPA may grant concessions to infrastructure developers within the port boundaries. Such infrastructure also requires licencing in accordance with the Petroleum Pipelines Act which is administered by NERSA and therefore leading to some overlapping jurisdiction. Currently, it is possible for the TNPA to grant 20 year concession agreements without considering the tariff to be charged (NERSA process). This might lead to stalling of projects if the investor is not happy with the NERSA approved tariff.

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<sup>12</sup> The Commission has found that cylinder inspection and filling is not complex.

- 6.4. Another scenario is that NERSA can issue an import and storage licence with limited consideration of the port development plans for the TNPA. In some cases the TNPA processes commence at a later stage and this tends to prolong the application process.
- 6.5. Policy harmonisation and regulatory clarity across the various bodies is required in order to allow for better decision making cognisant of outstanding processes by another body. This might also call for improved sequencing of these processes (where possible).

*Proposed recommendation*

- 6.6. In light of the above, the Commission proposes the following options:
  - 6.6.1. Introducing a bidding process which would be jointly run by NERSA and TNPA wherein potential entrants would be able to receive simultaneous approvals from both regulators after winning the bid;
  - 6.6.2. Alternatively, introducing a bidding process that would be overseen by an independent body such National Treasury as part of the key strategic infrastructure procurement programme;
  - 6.6.3. A review of the regulatory mandates conferred by the Ports Act and the National Energy Regulator Act. In particular, a review of the National Energy Regulator Act is recommended with the aim of removing all port related activities (licensing in particular) currently regulated by NERSA; and
  - 6.6.4. All licences that require execution and implementation at the ports need to get TNPA approval prior to all other subsequent licence applications.
- 6.7. The Commission requests submissions on how best this can be implemented given the complex nature of the infrastructure developments. The submissions should focus on the sequencing of the licencing process with the view of minimising regulatory costs and timeframes required to develop infrastructure..

**(ii) Refinery shutdowns**

- 6.8. The Commission found that refineries experience both planned and unplanned shutdowns. Annually, the average length of a planned shutdown was 17.3 days and the averaged unplanned shutdown lasted 9.9 days. The Commission's assessment has revealed a clear pattern indicating that planned shutdowns were staggered over time where no more than one refinery underwent a planned refinery shutdown at a point in time. The Commission has learnt that the dates for planned shutdowns

experienced by refineries are decided upon in collaboration with the South African Petroleum Industry Association (“SAPIA”) and the DoE.

- 6.9. The unplanned shutdowns are typically shorter in duration and are not staggered in the same way that the planned shutdowns were. Unplanned shutdowns however are said to be a result of technical issues experienced by refineries. What was of concern to the Commission were the unplanned shutdowns which occurred either at the same time as a planned shutdown at another refinery or occurred immediately after a refinery had experienced a planned refinery shutdown. The Commission is of the view that the refinery shutdowns serve to exacerbate the supply constraints faced by the domestic LPG industry (particularly when this occurs in winter where demand for LPG is high) and as such contribute significantly to the domestic shortages faced by the country.
- 6.10. The Commission requires submission from market participants on the impact of these shutdowns on their business and how these shutdowns can be better managed and how feasible is it to create a strategic reserve for LPG as in other fuels.

***(iii) Wholesale licences***

- 6.11. The Commission found that the issuing of wholesale licencing by the Department of Energy (“DoE”) is done without considering the long term sustainability of the industry. For instance, the significant requirements are: (i) licence fee of R1 000 (ii) a list of all storage and distribution facilities intended to be used, including shared storage and distribution facilities, and (iii) produce a business plan outlining investment plans. The Commission is of the view that these requirements, if not properly monitored and verified after issuing the licence, do not sufficiently encourage the level of investment required into the industry.

*Proposed recommendations*

- 6.12. In light of the above, the Commission proposes that the DoE should actively monitor whether the tangible investments as stipulated in the business plan by a wholesaler have been made.
- 6.13. The Commission requests submissions from industry on:
- 6.13.1. Detail on how the business plan projections can be better monitored by the DoE when the licence has been granted; and

6.13.2. How best the enforcement of the regulation requirements on trading licences can be better managed.

**(iv) Import aggregation**

6.14. The Commission has noted instances where some wholesalers were importing small volumes of LPG on behalf of other wholesalers especially during the winter periods (import aggregation). While the Commission acknowledges the role played by imports especially in winter, it is still concerned about the increased potential for coordinated behaviour amongst the wholesalers through the use of an import aggregator.

6.15. The Commission acknowledges that import aggregation (if done by independent parties) has advantages of reducing logistics and landed cost of the product in the country. Further, it is noted that imports will continue playing a key role in this market for extended periods of time.

*Proposed recommendation*

6.16. In light of this, the Commission recommends that no wholesaler, that is currently active in the wholesale level of the market, should be engaged with import aggregation. Import aggregation should be done by an independent party with no active interests in the wholesale level of the LPG value chain. The Commission invites further submissions on this.

**(v) Price Regulation**

6.17. The Commission has noted that the DoE has not been able to finalise the review of the MRGP since the issuing of a draft framework for comments in 2012. This is despite commitments made by the DoE that the MRGP would be reviewed periodically.

6.18. The Commission's comparative assessment has shown that the MRGP is lower than the landed import price for LPG for smaller volumes. The driving factor for the high cost of imported product relates to logistics, particularly given that South Africa imports smaller parcels. This indicates that the pricing of imported LPG product is not the impediment to importation but that LPG import efficiency and optimisation is the key to sourcing LPG at lower cost.

6.19. Further, the Commission believes that the benefits associated with the importation of larger parcels of LPG will result in the landed import price being lower than MRGP.

As such, the Commission is of the view that in order to encourage sustainable supply of LPG throughout the year, the focus of industry should be on the construction of larger import and storage facilities.

- 6.20. With regards to price monitoring, the Commission found limited evidence indicating effective monitoring and enforcement of regulated prices by the DoE. The Commission has learnt that the DoE does not monitor the MRGP and has limited resources to monitor the regulated retail price of LPG. This lack of monitoring results in some pricing abuse by the market participants.

#### *Proposed recommendations*

- 6.21. The Commission proposes that there should be a path towards a market driven price of LPG in the long term and effort should be expended to create an environment conducive for competition. The proposed recommendations below outline the Commission's proposals of the steps required to create an environment that is conducive for competition.

6.21.1. A greater focus on import efficiency and optimisation that would allow for increased import storage capacity and port infrastructure that can accommodate the delivery of larger parcels;

6.21.2. As an interim measure, the Commission has noted the lack of monitoring and thorough reviews of the price regulation methodology adopted by the DoE. As such, the Commission invites submissions on whether the DoE is still best placed to deal with this function and whether another regulator should assume this role. Alternatively, how DoE can better conduct effective monitoring and review of pricing methodology; and

6.21.3. Once there is sufficient capacity to supply LPG in the domestic market and constraints (both structural and regulatory) to competition are removed, the market should move towards deregulation. This proposal takes into account the completion of import and storage facilities currently under construction.

- 6.22. The Commission therefore requests submissions to this proposal and how best this can be implemented or proposal for an alternative proposal.

## **7. Conclusion**

- 7.1. Market participants and interested parties are encouraged to provide comments and further submissions on the preliminary recommendations by **07 June 2016**.