LIQUEFIED PETROLEUM GAS ("LPG") MARKET INQUIRY

REQUEST FOR FURTHER SUBMISSIONS

27 August 2015

1. Introduction and Purpose

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.

1.2. In accordance with the Terms of Reference of the LPG market inquiry (which was published in the Government Gazette No.37903 on 15 August 2014), the Commission has engaged with stakeholders through an initial call for submissions, targeted information requests, meetings and site visits. In total, the Commission received more than 68 submissions from stakeholders across the LPG value chain.

1.3. Arising from the submissions received thus far, market participants have indicated specific factors that may have an impact on competition. Accordingly, the Commission hereby requests that market participants provide further submissions[1] and information in respect of the concerns that are set out below. However, market participants are also welcome to provide additional information on any other issue not covered below.

1.4. Submissions should be as detailed as possible and any views or opinions expressed should be substantiated, as far as possible, by evidence.

1.5. Submissions and any additional queries in this regard should be emailed to lpg@compcom.co.za by 25 September 2015.

2. Identified concerns requiring further submissions

Preferential supply allocation

2.1. Market participants have raised concerns regarding the "long standing historical relationships" between LPG producers and certain large wholesalers which, it is argued, have the potential to lead to distortions in the market related to the supply allocation of LPG. In particular, new entrants have raised concerns around rationed supply allotted to them by LPG producers in favour of preferential allocation, through long term supply agreements. Some have raised concerns that LPG producers favour their formerly owned downstream entities.

[1] 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.

2.2. LPG producers on the other hand, indicated some general factors which are taken into consideration in their decision to allocate supply. This includes the history of volume offtake, credit terms, the customer's business profile and product availability to name a few.

2.3. Of concern is the extent to which these long term supply agreements create a constraint on the ability of small wholesalers to compete effectively in the market. As such, the Commission seeks further submissions on the abovementioned concerns and comments on *inter alia* whether this conduct may distort competition and whether or not this criteria acts as a barrier to entry for new entrants or the expansion of existing players. Further, submissions and comments should also highlight the minimum uptake required by "smaller players" to compete effectively and the extent to which this uptake may be feasibly reserved for the "smaller players" by LPG producers.

Bulk end-users ("end users") have a limited ability to switch

2.4. End-users have indicated that the reasons for switching suppliers relates broadly to pricing and service standards and therefore the artificial raising of costs associated with switching may pose anti-competitive harm especially if the incumbent supplier loses the contract due to a competitive bidding process. End-users state that contractual arrangements contribute to their inability to switch suppliers seamlessly and in the most cost-effective manner. The threat to business disruptions has allegedly led to some end-users "sticking" with an expensive incumbent and poor quality service. In instances where switching occurred, it came at a significant cost to the end-user.

2.5. Smaller wholesalers have also stated that the current regulatory environment and contractual arrangements serve as a potential barrier to their expansion as the incumbent LPG suppliers are often not willing to negotiate for the sale of existing equipment. This is said to be a barrier to switching for the end-user when making a decision to switch LPG suppliers.

2.6. The Commission therefore requests further submissions on the abovementioned concerns and *inter alia* potential mechanisms that would facilitate better switching between wholesalers should the customer wish to do so.

Cylinder exchange programme

2.7. Concerns with the cylinder exchange programme have also been noted especially by smaller players who feel excluded from participating in this programme due to the alleged “unfair conduct” of larger wholesalers. Some large wholesalers allegedly “refuse” to enter into cylinder exchange with smaller players and therefore allegedly impede their growth.

2.8. Smaller players allege that the larger wholesalers make it difficult for them to retrieve their cylinders by insisting on only a “one for one” exchange, thus refusing to give small wholesalers access to their cylinders, or increasing the transport cost of retrieving them.

2.9. In light of this, the Commission requests submissions on the abovementioned concerns and *inter alia* whether it is possible for the cylinder exchange programme to be rolled out to all players in the market and whether and how this programme may be better regulated. Further, the Commission requests detailed information regarding the advantages and disadvantages of the cylinder exchange programme.

Limited LPG import facilities and the associated cost of importing

2.10. Limited LPG import facilities are identified as a concern, more so because there are few licensed importers of LPG. The ability of these licenced importers to import LPG was deemed, by market participants, as dependent on import storage capacity available in the country. Market participants have indicated that there is a need for this storage capacity to be increased but there are significant barriers. It is estimated that at least 46 months (at a minimum) is required for an import facility or terminal to be licenced.[2]

2.11. Market participants have, however, stated that the current regulated price environment does not provide sufficient incentive to invest in increasing the domestic production capacity of LPG. Market participants identified the price differentials between the maximum refinery gate price (“MRGP”) and the landed price of imported LPG as a reason for rendering the importation of LPG not commercially viable given that the retail sale of LPG is also subject to price

[2] This figure is based on the estimated time required to process and acquire all the relevant documentation and authorisations required to operate an import facility.

regulation. Market participants allege that from a producer's perspective, despite the demand in the market, MRGP does not provide an incentive to invest further into LPG production. Producers instead have an incentive to switch production towards other products.

2.12. The Commission therefore requests submissions on the abovementioned concerns and *inter alia* how the licensing of import facilities may be improved. The response should also indicate which process in the licensing framework acts as a significant impediment and how this may be improved over time. Further, the Commission also requests submissions which clarify the role of different authorities in the licensing process.

2.13. Submissions may also set out if the pricing mechanisms should differ between LPG produced locally and imported LPG as well as provide proposals on whether and how the MRGP framework needs to be revised to facilitate investment in the LPG market

Presence of rogue traders

2.14. Several market participants have also highlighted the existence of rogue fillers/traders that illegally use legitimate market participants' assets in a prohibited practice commonly referred to as cross-filling. These rogue traders and illegal players do not incur investment costs as they rely on the use of the legitimate wholesalers' infrastructure or cylinders. Given the hazardous nature of LPG, it is prohibited for market participants to fill one another's cylinders as the risk for any hazard arising from a defective filled cylinder (or sometimes the filling of cylinders with other substances such as water etc.) lies with the owner of that cylinder. Market participants state that this practice leads to the under-utilisation of assets and a disincentive to invest in assets that can grow the market.

2.15. In light of this, the Commission seeks submissions on the abovementioned concerns and *inter alia* how the regulatory and enforcement mechanisms may be improved to limit the impact of rogue traders in the market. The Commission requests submissions on how LPG "allocations" to these rogue traders may be curtailed.

Price regulatory framework – the Maximum Refinery Gate Price ("MRGP")

2.16. MRGP may be defined as the maximum price that a producer may sell LPG. Market participants identified instances where they have been charged above the MRGP by some LPG producers. The market participants stated that additional items are added to the MRGP which include surcharges for gantry fees, transport levy and other miscellaneous cost items. Furthermore, some customers indicated that this amounts to possible price discrimination and makes it difficult to compete.

2.17. The Commission therefore requests further submissions regarding the abovementioned concerns including any additional evidence of instances where market participants were charged above MRGP.

Price regulatory framework – the Maximum Retail Price ("MRP")

2.18. Retailers expressed concern about the perceived high margins enjoyed by wholesalers at their expense. Retailers state that the retail margin provided for in the determination of MRP acts as a disincentive for them to further invest in the market.

2.19. Furthermore, market participants have also alleged that changes in the retail price of LPG is not as transparent as other petroleum products (petrol and diesel were the cited examples). The Commission also received claims that some retailers charge prices for LPG above the MRP. This was alleged to be prevalent especially in the remote areas of the country.

2.20. The Commission therefore requests submissions on the abovementioned concerns and *inter alia* how the MRP may be better communicated to the general public and how retailers' margins may lead to sustainable businesses.