NATIONAL ENERGY REGULATOR

In the matter regarding

THE APPLICATION FOR EXTENSION OF PIPED-GAS MAXIMUM PRICES

By

Virtual Gas Network (Pty) Ltd

DECISION

On 22 January 2015, the National Energy Regulator decided as follows:

1. approved the extension of the Virtual Gas Network (Pty) Ltd (“VGN”) maximum price of gas of R278/Gigajoule for the period 01 July 2014 to 30 June 2015;

2. that discounts from the maximum prices are allowed and must be applied in accordance with the non-discrimination provisions of section 22 of the Gas Act;

3. that the approved maximum price is exclusive of VAT; and

4. that the Energy Regulator decision remains in effect until the date of approval of another maximum price by the Energy Regulator.
1. **APPLICABLE LAW**

1.1 The legal basis for the Energy Regulator to regulate prices of piped-gas is derived from the National Energy Regulator Act, 2004 (Act No. 40 of 2004) (‘the NERSA Act’), read with the Gas Act, 2001 (Act No. 48 of 2001), (“the Gas Act”).

2. **BACKGROUND**

**The Methodology to Approve Maximum Prices for Piped-Gas in South Africa (2011)**

2.1 In terms of section 4(g) of the Gas Act, the Energy Regulator must, as appropriate, in accordance with this Act regulate prices in terms of section 21(1)(p) in the prescribed manner.

2.2 Section 21(1) (p) of the Gas Act prescribes that the Energy Regulator may impose licence conditions within the following framework of requirements and limitations: ‘maximum prices for distributors, reticulators and all classes of consumers must be approved by the Gas Regulator where there is inadequate competition as contemplated in Chapters 2 and 3 of the Competition Act, 1998 (Act No. 89 of 1998)’.

2.3 The essence of section 4(g), therefore, is that when the licensee holds a licence that contains a condition in terms of section 21(1)(p), then such licensee’s maximum prices must be approved by the Energy Regulator in the prescribed manner where there is inadequate competition.

2.4 Regulation 4 of the Piped Gas Regulations, 2007 (published under Government Notice No. R. 321 in Gazette No. 29792 on 20 April 2007) (“Piped Gas
Regulations”) dealing with the price regulation principles and procedures provides as follows under sub regulation (3) and (4), respectively –

2.4.1 that the Energy Regulator must, when approving the maximum prices in accordance with section 21(1)(p) of the Act, *inter alia* be objective based on a systematic methodology applicable on a consistent and comparable basis; and

2.4.2 that the maximum prices referred to in sub regulation (3) must enable the licensee to –

(a) recover all efficient and prudently incurred investment and operational costs; and

(b) make a profit commensurate with its risk.

2.5 In line with this particular requirement, the National Energy Regulator has developed the Methodology to Approve Maximum Prices of Piped-Gas in South Africa, 2011 (‘the Maximum Pricing Methodology’ or ‘the Methodology’). The Methodology is available on the National Energy Regulator’s website at www.nersa.org.za.

**Determination of Inadequate Competition**

2.6 Approving maximum prices and the use of the Methodology are contingent on the National Energy Regulator determining that ‘there is inadequate competition as contemplated in Chapters 2 and 3 of the Competition Act, 1998 (Act No. 89 of 1998) (‘Competition Act’).’

2.7 Therefore, for the National Energy Regulator to regulate maximum prices of piped-gas, it must be of the view that there exist market conditions or market features indicating inadequate competition in line with the provisions of Chapters 2 and 3 of the Competition Act.
2.8 The determination of inadequate competition contemplated in section 21(1) (p) of the Gas Act is made by the Energy Regulator outside of this methodology from time to time. The determination of inadequate competition was approved by the Energy Regulator on 08 February 2012 and is reviewed every three years.

2.9 The Maximum Pricing Methodology also provides for the determination of a trading margin, which is referenced to the Tariff Guidelines.

**Relationship to the Tariff Guidelines**

2.10 According to section 4(h) of the Gas Act, the Energy Regulator has a duty to ‘monitor and approve, and if necessary regulate, transmission and storage tariffs and take appropriate actions when necessary to ensure that they are applied in a non-discriminatory manner as contemplated in section 22’.

2.11 In order to implement this mandate, the National Energy Regulator developed the Guidelines for Monitoring and Approving Piped-Gas Transmission and Storage Tariffs in South Africa, 2009 (‘the Tariff Guidelines’). The Tariff Guidelines are available on the National Energy Regulator’s website at [www.nersa.org.za](http://www.nersa.org.za).

2.12 Hence, the Tariff Guidelines give guidance on tariff-related activities, which are charges for gas services and which must be added to the piped-gas energy price(s).

**The Piped-Gas Regulations**

2.13 The maximum price determination principles outlined in the Maximum Pricing Methodology, are further informed by the Piped-Gas Regulations. The following are pertinent to this methodology.

2.14 Sub-regulation 4(3) prescribes that the Energy Regulator must, when approving the maximum price in accordance with Section 21(1)(p) of the Act:
a) be objective i.e. based on a systematic methodology applicable on a consistent and comparable basis;

b) be fair;

c) be non-discriminatory;

d) be transparent;

e) be predictable; and

f) include efficiency incentives.

2.15 Sub-regulation 4(4) prescribes that the maximum prices referred to in sub-regulation 4(3) must enable the licensee to:

a) recover all efficient and prudently incurred investment and operation costs; and

b) make a profit commensurate with risk.

2.16 Sub-regulation 4(6) then requires that, when gas is sold, the accompanying invoice must itemise the constituent elements of the total price reflected on the invoice, including at least the cost of gas, and transport tariffs and any other charges.

2.17 Annexure A of the Regulations provides the definition of the classes of customers as classified by their annual gas consumption in Gigajoules as follows:

<table>
<thead>
<tr>
<th>CLASS</th>
<th>ANNUAL GAS CONSUMPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class 1</td>
<td>Less than 400 GJ pa</td>
</tr>
<tr>
<td>Class 2</td>
<td>401 GJ pa</td>
</tr>
<tr>
<td></td>
<td>to 4 000 GJ pa</td>
</tr>
<tr>
<td>Class 3</td>
<td>4 001 GJ pa</td>
</tr>
<tr>
<td></td>
<td>to 40 000 GJ pa</td>
</tr>
<tr>
<td>Class 4</td>
<td>40 001 GJ pa</td>
</tr>
<tr>
<td></td>
<td>to 400000 GJ pa</td>
</tr>
<tr>
<td>Class 5</td>
<td>400 001 GJ pa</td>
</tr>
<tr>
<td></td>
<td>to 4 000 000 GJ pa</td>
</tr>
<tr>
<td>Class 6</td>
<td>&gt; 4 000 000 GJ pa</td>
</tr>
</tbody>
</table>
2.18 These legislative aspects, as prescribed by the Gas Act are essential in defining the scope and nature of the Maximum Pricing Methodology developed by the National Energy Regulator.

Approving maximum prices of piped-gas

2.19 As the Maximum Pricing Methodology highlights, in approving maximum piped-gas prices:

- the National Energy Regulator will not set prices but will review maximum piped-gas price applications prepared by licensees or applicants;
- the National Energy Regulator may request licensees or applicants to amend maximum prices; and
- the National Energy Regulator may approve or decide not to approve maximum prices.

2.20 The process of piped-gas maximum prices application is as follows:

- The Energy Regulator has requested licensees or applicants to submit their maximum piped-gas price applications based on the Methodology approved by the Energy Regulator.
- To ensure consistency of applications and predictability of analysis of the applications, the National Energy Regulator has specified the following:
  a) prescribed sources of information that must be used for the input variables in the maximum price calculations;
  b) prescribed weights applied to energy price indicators; and
  c) the Methodology to determine trading margins.
- Applicants must provide information regarding the assumptions made in the price calculation, as well as the details of the calculation.

2.21 This application must:
be provided on an annual basis, although applicants are allowed to apply for approval of maximum prices for a longer or shorter period; and

- indicate the manner and frequency of price adjustment to be approved by the Energy Regulator.

2.22 The Methodology further states that, ‘NERSA will periodically conduct reviews of approved prices to assess the impact and to verify whether the prices comply with the requirements of the Act and the Regulations’.

3. THE APPLICANT

3.1 VGN (licence number Gala.tr.F1/1447/2009) is a wholly owned subsidiary of CNG Holdings (Pty) Ltd, a registered company established by Absorption Technologies (Pty) Ltd and private investors represented by Tricor Financial Services (Pty) Ltd.

3.2 The Energy Regulator granted VGN licences on 27 May 2010, subject to appropriate licence conditions, for the operation of a gas storage facility in the Langlaagte area of the City of Johannesburg Metropolitan Municipality; and for trading in gas in 20 geographic areas of the Gauteng, Mpumalanga, and KwaZulu-Natal provinces.

3.3 The trading areas listed in the licence condition are:

- City of Johannesburg Metropolitan Municipality;
- Pretoria of the Tshwane Metropolitan Municipality;
- Alrode of the Ekurhuleni Metropolitan Municipality;
- Bapelegi of the Tshwane Metropolitan Municipality;
- Krugersdorp of the Mogale City Local Municipality;
- Benoni/Boksburg of the Ekurhuleni Metropolitan Municipality;
- Kempton Park of the Ekurhuleni Metropolitan Municipality;
- Germiston East of the Ekurhuleni Metropolitan Municipality;
- Meyerton of the Midvaal Local Municipality;
- Olifantsfontein of the Ekurhuleni Metropolitan Municipality;
- Germiston West of the Ekurhuleni Metropolitan Municipality;
- Rosslyn of the Tshwane Metropolitan Municipality;
- Sasolburg of the Metsimaholo Local Municipality;
3.4 VGN is a relatively new entrant to the market. It started operating commercially around mid-2013. Of the above listed 20 areas that VGN is licensed to operate, however, VGN has since sent a letter to the Energy Regulator included as one of the areas it is licensed to trade in.

3.5 VGN’s business model is to purchase gas from Egoli Gas, compress the gas into special cylinders at the Langlaagte Compression Facility then supplies daughter stations situated at customer sites and CNG filling stations run by NGV Gas (Pty) Ltd.

3.6 VGN customers are industrial and commercial customers that are /or were The trader plans to also service smaller residential customers in future.

3.7 Below is a pictorial depiction of the CNG business model. The maximum price request is for the VGN business arm (the shaded part in the picture below):
4. **2014/15 VGN MAXIMUM PRICE REQUEST**

4.1 On 14 November 2014, VGN sent a letter to the Energy Regulator requesting approval for the continued use of the maximum price of piped gas of R278/GJ for the period 01 July 2014 to 30 June 2015.

4.2 VGN supplies gas to companies trading as [Redacted] and that it would like to continue using the approved maximum price of R278/GJ.

4.3 Below are the volumes and prices of VGN customers in the year July 2013 to June 2014:

5. **NERSA ANALYSIS OF THE VGN REQUEST**

5.1 According to the section 3.4 of the Methodology, a licensee can choose the frequency of a price review. In this instance, VGN is not requesting a review of
the maximum price but wants the approved maximum price to remain in effect for another year.

5.2 VGN has requested an extension of its maximum price of piped gas because it had only applied for one year ending 30 June 2014. So instead of applying for a new maximum price, the gas trader is requesting the same price for another year.

5.3 Table 1 above shows that VGN charged below the maximum price in the year and it would like to continue charging below the maximum price.

5.4 Furthermore, VGN has a capacity to service an annual volume of almost 0 of gas. In the year 01 July 2013 to 30 June 2014, VGN 0 of gas, and this translates to capacity usage of 0.

5.5 To calculate the approved maximum price of R278/GJ, the financial data used by VGN in the maximum price application were average figures pertaining to the calendar years 2013 and 2014 (that is Jan – Dec 2013 data plus Jan - Dec 2014 data divided by 2). VGN had also estimated to 0 in the maximum price period. The applicant justified the use of the average data, indicating that it was the first time it would be operating and the estimates provided would be sensitive to the rate of expansion and the volume of gas distributed.

5.6 An assessment of the incurred fixed costs also shows that if VGN had used estimates pertaining to the maximum price application period, the maximum price would be too high.

5.7 According to the VGN management, the rate of expansion in the previous year was lower than anticipated and therefore, the gas trader would like to continue on the approved maximum price to ensure that its customers pay a levelled price whilst the licensee does not lose incurred costs.
Impact of extending the maximum price

5.8 Extending the effective period of the currently approved maximum price would ensure that customers pay a lower price whilst the licensee does not lose incurred costs.

5.9 This is because the once off costs associated with establishing the business including the cost of securing offices, land, transportation vehicles with compressed gas cylinders as well as concept marketing are very high at the business commencement level. The current head office and organisational structure of the business is designed to support operations in the above mentioned licensed areas but currently, the business is operating in only two of the licensed areas. According to the Methodology, all prudently incurred expenses are allowed to be recovered in the trading margin as a pass-through. Therefore instead of expensing all the set up costs in the current pricing applications, the costs were capitalised. Capitalising the expenses and amortising them over the same period as the assets useful life ensured that the licensee does not lose incurred costs.

5.10 On the other hand, the volumes currently being sold by VGN are still too low to meaningfully establish the price per gigajoule. Therefore the estimates and milestones used in the previous application, such as being able to sell over 1 million per annum have not been met. The volume sold in the 2013/14 financial year of VGN is 0.4 million. The volume used in the 2013/14 maximum price was the licensee’s estimated maximum operational capacity. This has the effect of reducing and levelling the tariff, ensuring that when the licensee reaches its full operational capacity, there will not be a large swing of the maximum price.

5.11 VGN’s current prices are all below the approved maximum price and the company requests that it continues with its current maximum price of piped gas.
6   STAKEHOLDER CONSULTATION IN DECISION-MAKING PROCESS

6.1 The National Energy Regulator’s preliminary assessment of the request for an extension was published on 04 December 2014. Certain elements of the maximum price application were deemed by the National Energy Regulator to be confidential and were excluded from the published application. The closing date for written comments was 14 January 2014.

6.2 On 09 December 2014, an invitation to attend and/or make representations at the public hearing scheduled for 15 January 2015 was published in the following newspapers: Business Day, Isolezwe, The Star, Mail and Guardian, and Sunday Times.

6.3 The Energy Regulator did not receive any comments on the extension request.

7.   CONCLUSION

7.1 On the conspectus of the facts and evidence, it is appropriate and in compliance with the requirements of the National Energy Regulator Act, 2004 (Act No. 40 of 2004) to make the decision set out above. It finds a reasonable balance between the interests of all stakeholders concerned.