



## **Tariff Methodology for Petroleum Loading facilities and Petroleum Storage facilities**

### **CONSULTATION DOCUMENT**

28 April 2017

This consultation document relates to the Tariff Methodology for Petroleum Loading Facilities and Petroleum Storage Facilities.

#### **Background**

On 4 April 2008, the then minister of Minerals and Energy had in terms of section 33 (1) of the Petroleum Pipelines Act, 2003 (Act No. 60 of 2003) gazetted the regulations ('the Regulations'). Regulation 4(7) (a) of the regulations prescribed that *the Regulatory Asset Base (RAB) be calculated as the total investment in assets*. This meant that the Energy Regulator had to use the original cost of assets in determining tariffs for the licensed facilities. Based on the Regulations, the Energy Regulator approved a Tariff Methodology using the Trended Original Cost (TOC).

On 28 August 2015, the Minister of Energy published amendments to the Regulations. The amended Regulations prescribe that the *RAB fairly reflect the investment in the RAB*. This amendment allows the Energy Regulator flexibility in terms of the methodology to use and does not confine it to using the TOC methodology. Following this amendment, the Energy Regulator embarked on a process to review and change its methodology to align with the new regulations.

During the time of gazetting the amended Regulations, the Energy Regulator was in the process of changing its Tariff Methodology from the TOC to Replacement Cost no Depreciation (RnD) in order to converge with the DoE practice of fuel price regulation. However, after careful consideration of whether section 28(3)(a) of Petroleum Pipelines Act, No. 60 of 2003 (PPA) permits the licensee to recover its actual investment under the RnD methodology, the Energy Regulator decided not to implement the RnD but rather IOC which is similar to RnD.

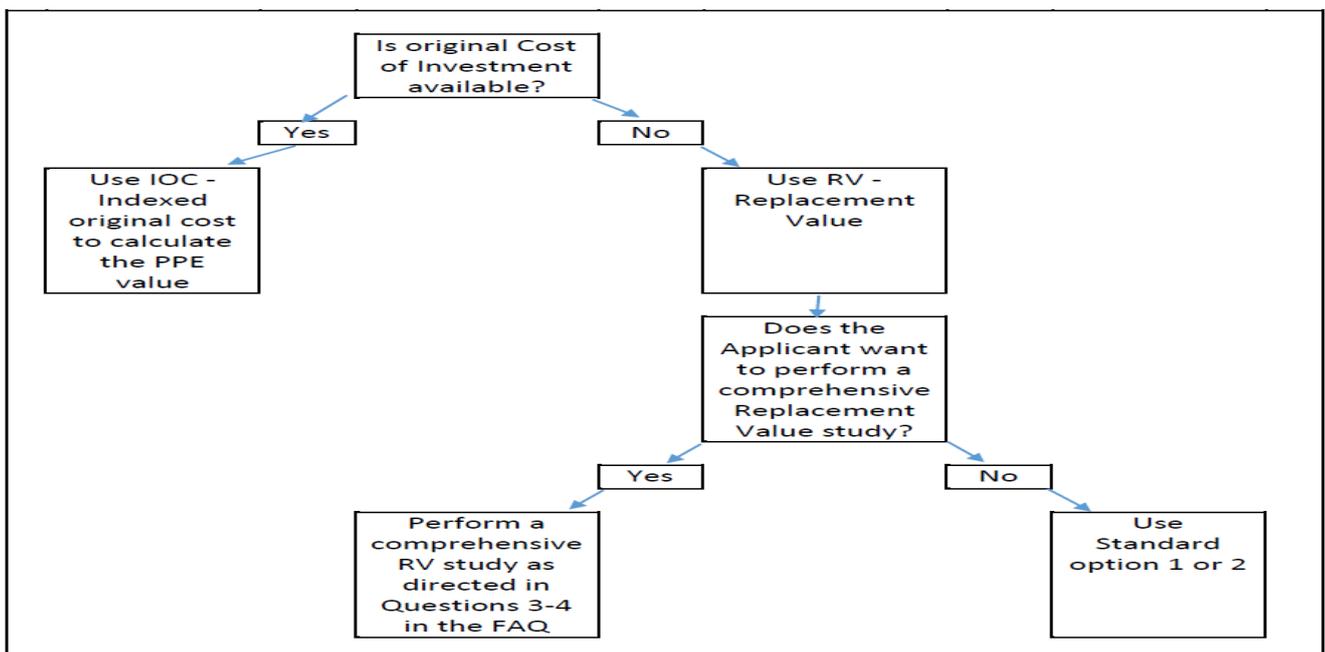
The change in the Tariff Methodology was done in support of government objectives of ensuring that there is investment in the petroleum storage facilities.

As a result of the aforementioned reasons, the Energy Regulator decided to move from the TOC Methodology to the Indexed Original Cost (IOC)/Replacement Value (RV) Methodology. The standard costing options were added in the new Tariff Methodology for ease of calculation and to streamline the application process for both the applicants and the Energy Regulator.

### Discussion

The New Tariff Methodology does away with depreciation as an element of the calculation of Allowable Revenue (AR) and uses the basis of IOC or RV, where original investment cost information is not available, to establish the value of Property Plant and Equipment (PPE).

This Tariff Methodology also accommodates a new development in the form of a standard costing model intended to provide licensees with options to apply for tariffs on a simplified basis, which yields benefits in terms of a shorter processing time period. Standard cost option 1 is based on standard costing, volumes and tariffs, and standard cost option 2 is based on standard costing, with licensees' own volumes and tariff design. The options available to licensees are demonstrated in the following decision tree:



Over the last 12 months, the Energy Regulator has been monitoring the results of the outcomes of the tariffs approved based on the new Tariff Methodology.

One of the objects of the Petroleum Pipelines Act, 2003 (Act No. 60 of 2003) is to encourage efficient operation and use of the petroleum pipelines, loading facilities and storage facilities. In the Energy Regulator's review of the Tariff Methodology, the Energy Regulator identified that it is impossible to ensure efficient operation of petroleum storage and loading facilities while the Regulatory Asset Base (RAB), operating costs, and in some cases, volumes are based on Standard variables and not actual costs incurred by the licensees. In addition to ensuring efficiencies, the following challenges were also identified:

- a) Tariffs applied for, using the Standard Costing Options, are significantly higher than tariffs calculated on the TOC basis. This is due to the RAB values used being based on the Department of Energy's EPCM study, operating expenditure based on the standard cost of all licensees irrespective of the size of the facility, and volumes based on 24 turns of the design capacity for Standard Costing Option 1;
- b) There is no criteria for eligibility and efficiency and therefore the Energy Regulator cannot verify the eligibility and efficiency of the assets values as to whether they are overstated;
- c) The New Tariff Methodology does not allow for clawbacks, and therefore no adjustments can be made in instances where projections are significantly inaccurate; and
- d) The misalignment between the design capacities used by licensees when calculating a tariff based on Standard Costing Options and the design capacities in the license conditions.

Given the identified challenges with the new Tariff Methodology, the Energy Regulator has embarked on the process of reviewing its Tariff Methodology in order to develop a Tariff Methodology that addresses the challenges identified with the current Tariff Methodology.

In the interim, the Energy Regulator proposes reverting to the *2<sup>nd</sup> version of the Tariff Methodology for the Approval of Tariffs for the Petroleum Storage Facilities and Petroleum Loading Facilities, approved on 31 March 2011*, until such time a new Tariff

Methodology that addresses the identified challenges has been developed and approved. This Methodology is available on the NERSA website under [www.nersa.org.za](http://www.nersa.org.za).

Members of the Public are requested to comment on this proposal by submitting written comments by 28 May 2017. Details about the Public Hearing will be published by the Energy Regulator in due course.

Tariff applications already submitted to the Energy Regulator, using the New Tariff Methodology, will be assessed and decided upon, using the New Tariff Methodology (i.e. Tariff Methodology for Petroleum Storage and Loading Facilities Version 3 of 29 March 2016).