NATIONAL ENERGY REGULATOR OF SOUTH AFRICA

CONSULTATION DOCUMENT

INQUIRY INTO FEATURES OF THE GAS DISTRIBUTION LEVEL OF THE SOUTH AFRICAN PIPED-GAS VALUE CHAIN THAT MAY IMPEDE THE ACHIEVEMENT OF THE OBJECTS OUTLINED IN SECTION 2(a), 2(b), 2(c), 2(d), 2(e), 2(h) AND 2(j) OF THE GAS ACT

DATE: OCTOBER 2020

Contents

1. INTRODUCTION

1.1. The National Energy Regulator of South Africa (NERSA) is mandated in terms of the National Energy Regulator Act, 2004 (Act No. 40 of 2004) to regulate the electricity, piped-gas and petroleum pipeline industries in terms of the Electricity Regulation Act, 2006 (Act No. 4 of 2006), the Petroleum Pipelines Act, 2003 (Act No. 60 of 2003) and the Gas Act, 2001 (Act No. 48 of 2001) ('the Gas Act').

1.2. On 8 September 2020, NERSA initiated an inquiry in terms of section 4(d) of the Gas Act, and rule 18 of the Rules made in terms of section 34(3) (j, k, l) of the Gas Act ('the Gas Act Rules'), in accordance with the regulations made in terms of the Promotion of Administrative Justice Act, 2000 (Act No. 3 of 2000) ('PAJA').

1.3. NERSA initiated this inquiry because it has reason to believe that there may be features of the gas distribution level of the South African piped-gas value chain that have the effect of impeding the achievement of the following objects of the Gas Act:

(i) Section 2(a): 'promote the efficient, effective, sustainable and orderly development and operation of gas transmission, storage, distribution, liquefaction and re-gasification facilities and the provision of efficient, effective and sustainable gas transmission, storage, distribution, liquefaction, re-gasification and trading services'.

(ii) Section 2(b): 'facilitate investment in the gas industry'.

(iii) Section 2(c): 'ensure the safe, efficient, economic and environmentally responsible transmission, distribution, storage, liquefaction and re-gasification of gas'.

(iv) Section 2(d): 'promote companies in the gas industry that are owned or controlled by historically disadvantaged South Africans by means of licence conditions so as to enable them to become competitive'.

(v) Section 2(e): 'ensure that gas transmission, storage, distribution, trading, liquefaction and re-gasification services are provided on an equitable basis and that the interests and needs of all parties concerned are taken into consideration'.

(vi) Section 2(h): 'promote the development of competitive markets for gas and gas services'.

(vii) Section 2(j): 'promote access to gas in an affordable and safe manner'.

1.4. These features include, *inter alia*:

(i) The current legislative framework, which provides distribution licensees with a monopoly position on the distribution network, within their exclusive distribution areas, without also providing for compulsory third-party access, and the regulation of distribution tariffs. This may impede competition and transformation in the gas industry where there is existing gas distribution infrastructure. Such impediment is contrary to the objects of the Gas Act, which, inter alia, require the Energy Regulator to facilitate and promote access to affordable gas services.

(ii) The unregulated status of the distribution tariffs further gives the monopoly distribution network owner and operator the ability to charge inefficient monopoly tariffs. Such unregulated monopoly tariffs appear to have led to a trend whereby an increasing number of eligible customers are opting to by-pass the existing distribution facilities (and thus the unregulated monopoly distribution tariffs) to connect directly to transmission facilities, with the view to save costs.[1] This has resulted in some concerns being raised regarding the orderly development of pipeline infrastructure, which are discussed further in section 3.4 of this document.

(iii) Certain concerns were also raised by third parties regarding the practical features and implications of the exclusive distribution areas, particularly insofar as they relate to third-party access and interconnections to distribution infrastructure. These concerns are outlined in more detail in section 3.5 of this document.

1.5. In relation to inquiries, NERSA derives:

(i) a general statutory mandate to, appropriately and in accordance with the Gas Act, undertake inquiries into the activities of licensees from section 4(d) of the Gas Act; and

(ii) a specific statutory mandate to conduct own-initiated inquiries into the activities of licensees from rule 18 of the Gas Act Rules. NERSA has an unlimited scope as to the type of matters that may be investigated in this regard.

1.6. The purpose of this inquiry is to gather information that will allow NERSA to examine whether there are features or a combination of features of the distribution level of the South African piped-gas industry value chain that may be impeding the achievements of the objects of the Gas Act listed in paragraph 1.3 above.

1.7. Accordingly, this consultation document provides a basis for discussion from which NERSA will facilitate engagement, and gather information regarding features of the distribution level of the South African piped-gas industry value chain that may be impeding the achievements of the objects of the Gas Act listed in paragraph 1.3 above.

[1] An 'Eligible Customer' is, by definition in section 1 of the Gas Act, 'a customer who in the prescribed manner may buy gas directly from suppliers without the intervention of a distribution company'. The qualifying thresholds or requirements for an eligible customer are set out in Regulation 3 of the Piped-Gas Regulations *(published under Government Notice No. R. 321 in Government Gazette No. 29792 on 20 April 2007).*

1.8. Interested parties are hereby invited to provide written comments by 23 November 2020, which the Energy Regulator will consider in its assessment of the features of the distribution level of the South African piped-gas industry value chain that may be impeding the achievements of the objects of the Gas Act.

1.9. Furthermore, a public hearing on this matter will be held in due course.

1.10. The above consultation process is conducted in terms of section 10(1) of the National Energy Regulator Act, 2004, which provides that every decision of the Energy Regulator must, *inter alia,* be in writing, and consistent with the Constitution and all applicable laws, and taken within a procedurally fair process in which affected persons have the opportunity to submit their views and present relevant facts and evidence to the Energy Regulator.

1.11. Section 2 below outlines the timeframes for NERSA's consultation schedule and completion of this inquiry.

2. CONSULTATION PROCESS

Table 1: Consultation schedule

Activities	Date
Publication of the consultation document of the inquiry into features of the gas distribution level of the South African piped-gas industry value chain that may impede the achievement of the objects of the Gas Act	26 October 2020
Stakeholder consultation workshops (held online using Microsoft Teams)	6 November 2020
Deadline for written submissions on the consultation document for the inquiry	30 November 2020
Public hearing	December 2020
Effective date for publishing inquiry findings and recommendations	31 March 2021

Written comments on this consultation document must be sent to:
gcm@nersa.org.za

3. FEATURES THAT MAY IMPEDE THE ACHIEVEMENT OF THE OBJECTS OF THE GAS ACT

3.1. Overview

3.1.1. The South African piped-gas industry value chain continues to be dominated by Sasol Gas, who has a vertically integrated monopoly or near monopoly position throughout the piped-gas value chain.

3.1.2. In this regard, Sasol Gas still maintains a monopoly position in respect of gas infrastructure through its ownership and operation of gas transmission and distribution pipelines in South Africa. In particular, Sasol Gas has been granted exclusivity in respect of the geographic areas in which its distribution infrastructure is located, thus giving it a monopoly position on its distribution network. In addition, Sasol Gas is currently also still the dominant, near-monopoly upstream supplier of gas to independent traders.

3.1.3. The only level of the gas supply chain where Sasol Gas does not hold a monopoly position is at the trading level, where Sasol Gas and six other independent gas traders are active.[2] However, even with this number of traders active in the market, Sasol Gas has still maintained an irrefutably dominant position at the trading level of the piped-gas value chain.

3.1.4. It is against this background that the features of the distribution level of the piped-gas value chain that may be causing market failures and impede the achievement of the objects of the Gas Act, are outlined.

3.1.5. In this regard, the subsections below discuss the existence and rationale for exclusive distribution areas in the South African piped-gas industry value chain, the legislative gaps in placing a competitive constraint on the legal monopolies created by the aforementioned exclusive distribution areas, as well as other features highlighted by industry participants that may be creating market failures and prevent the achievement of the objects of the Gas Act.

3.2. The existence of exclusive distribution areas

3.2.1. The Gas Act contains certain provisions that provide the terms and conditions pertaining to infrastructure ownership, particularly distributors, including the following:

(i) Section 21(1)(m) of the Gas Act states that a distributor will be granted construction, operation and trading licences for its exclusive geographic area. The construction and operation licences will be exclusive for the period of validity of such licences and the trading licence will be exclusive for a period determined by the Energy Regulator.

[2] These include: SLG/SL-CNG, VGN/NGV, NOVO, Egoli Gas, Tetra4 and Evraz.

(ii) Section 21(1)(n) of the Gas Act states that an exclusive geographic area must be based on the distributor's ability to supply present and future potential customers at competitive prices and conditions.

(iii) Section 21(1)(o), states that gas must be supplied by a licensed distributor within its exclusive geographic area to any person on request, if such service is economically viable.

(iv) Section 21(1)(h) provides that licensees must allow interconnections with the facilities of suppliers of gas, transmitters, storage companies, distributors, reticulators and eligible customers, as long as the interconnection is technically feasible and the person requesting the interconnection bears the increased costs occasioned thereby, which must be taken into account when setting their tariffs.

3.2.2. As indicated above, section 21(1) (m) of the Gas Act states that a distributor will be granted construction, operation and trading licences for its exclusive geographic area. This implies that no other party can own distribution infrastructure in an exclusive geographic area without the express permission of the incumbent in the said area.

3.2.3. In addition, according to section 21(1)(h) of the Gas Act, licensees must allow interconnections to, *inter alia*, their distribution pipelines, provided that the interconnection is technically feasible and provided that the person requesting the interconnection bears the cost of that interconnection.

3.2.4. In practice, therefore, where independent gas traders or other licensees contribute or pay the full amount for a connection to the incumbent's existing exclusive distribution network, the incumbent (Sasol Gas) retains ownership of the infrastructure required to connect to its distribution network. However, despite taking ownership, Sasol Gas has previously reported to NERSA that it does not include the cost of the asset in its Regulatory Asset Base. This means that Sasol Gas does not get rewarded for an asset it did not pay for. This claim, however, cannot be corroborated until thorough investigation on assets and pricing has been conducted. The Energy Regulator has no legal mandate to regulate a tariff pertaining to the cost associated with gas transported through the licensed distribution network. This regulatory gap should be resolved through legislative amendments to the Gas Act.

3.2.5. It is clear from the above that the current legislative framework provides distribution licensees with a monopoly position on the distribution network, within their exclusive distribution areas, without providing for compulsory third-party access or the regulation of distribution tariffs. This impedes competition and transformation in the gas industry where there is existing gas distribution infrastructure, which is contrary to the objects of the Gas Act, which require the Energy Regulator to facilitate and promote access to affordable gas services.

3.2.6. Details of the rationale for such exclusive distribution areas are set out in the subsection below. It is worth pointing out that exclusivity rights come with obligations placed on the licensee that is granted such exclusive power to operate and trade gas over the distribution network.

3.3. Rationale for exclusive distribution areas and regulatory gaps

3.3.1. The rationale for exclusive gas distribution in a specific geographic area is mainly to promote the efficient and orderly development of gas distribution infrastructure. Gas distribution has historically been regarded as a natural monopoly, where a single set of gas distribution facilities (i.e., a single network) could serve a number of customers within a specific geographic area more efficiently than multiple sets of gas distribution networks.

3.3.2. Gas distribution pipelines are considered high-cost facilities because they involve the transportation of smaller volumes of gas at lower pressures over shorter distances to a number of individual customers within a specific geographic area. The pipelines are developed as an integrated network to, among others, allow for the synchronisation between the gas supply source and the multiple off-take points in different locations. Thus, under such circumstances, exclusivity is granted to facilitate the integrated development of the network. It also serves to provide an incentive to the investor by allowing it to recoup its investments.

3.3.3. However, such exclusivity is usually accompanied by other legislation that would serve to place a competitive constraint on these legal monopolies in the absence of competition, including the regulation of tariffs and mandatory third-party access to such exclusive distribution infrastructure. This is absent from the legislation governing the South African piped-gas industry, and may be one of the key features of the market that are causing market failures and preventing the achievement of the objects of the Gas Act, as listed in paragraph 1.3 above.

Questions

1. What are your views regarding the rationale for the granting of exclusive distribution areas outlined above, namely, to promote the efficient and orderly development of gas distribution infrastructure, to facilitate the integrated development of the network, and to provide an incentive to the investor by allowing it to recoup its investments? Please elaborate.

2. In your opinion, what other measures could be put in place, other than the granting of exclusive distribution areas, that would allow first-mover investors in distribution infrastructure to recoup their investments? Please elaborate.

3. To what extent are the regulatory gaps outlined above, namely the unregulated status of the distribution tariff and the lack of mandatory third-party access to exclusive distribution infrastructure, likely to cause market failures in the piped-gas industry and prevent the achievement of the objects of the Gas Act? Please elaborate.

4. Please provide details of any additional regulatory gaps, other than the unregulated status of the distribution tariff and the lack of mandatory third-party access to exclusive distribution infrastructure, that this inquiry should consider? Please elaborate.

3.4. Unregulated distribution tariffs and the effects thereof on orderly development of infrastructure

3.4.1. As indicated in the subsection above, the current legislative framework provides distribution licensees with a monopoly position on the distribution network, within their exclusive distribution areas. The unregulated status of the distribution tariff further gives the monopoly distribution network owner and operator the ability to charge inefficient monopoly tariffs.

3.4.2. The ability to charge inefficient monopoly tariffs not only has the potential effect of exploiting customers, but may also have an impact on the orderly development of pipeline infrastructure in the industry.

3.4.3. To this end, the aforementioned unregulated monopoly tariffs appear to have led to a trend whereby an increasing number of eligible customers are opting to by-pass the existing distribution facilities (and thus the unregulated distribution tariffs) to connect directly to transmission facilities with the view to save costs.

3.4.4. This trend results in some concerns being raised regarding the orderly development of pipeline infrastructure and the sustainability of infrastructure investments.

3.4.5. To this end, given the close proximity of the eligible customers' new interconnecting transmission infrastructure to that of the existing distribution infrastructure, challenges may arise in respect of safety, e.g. in respect of activities related to the maintenance of infrastructure in close proximity to each other and the ability of new licensees to respond to issues such as gas leakages. Moreover, given the economies of scale related to gas pipeline infrastructure, the duplication of pipeline infrastructure may lead to stranded assets and issues with the sustainability of such infrastructure investments.

3.4.6. In addition to this, the impact of the decrease in volumes sold through the distribution network is that the distribution tariffs will increase further, as there would be fewer customers remaining on the distribution network to bear the cost of the network. This will have the most significant impact on those customers that do not meet the threshold of being eligible customers and who are therefore unable to switch to connecting directly to transmission facilities.

3.4.7. It is, however, also worth noting that the ability and threat of large end-user customers switching from using the incumbent distributor's distribution infrastructure to directly connecting to transmission infrastructure may serve to place some competitive constraint on the incumbent distributor in respect of the tariffs charged and services provided on the distribution network to its customers.

3.4.8. Having regard to the factors outlined above, this inquiry will seek to gather information that will enable it to assess the impact of the unregulated status of the distribution tariff on safety, sustainable investments, and the orderly development of, and competition within, the gas industry.

Questions

5. What are your views regarding the impact of the migration of eligible customers from the existing distribution facilities to connecting directly to transmission facilities on safety, sustainable investments and the orderly development in the gas industry? Please elaborate.

6. What are your views regarding the impact of the migration of eligible customers from the existing distribution facilities to connecting directly to transmission facilities on competition at the transmission and distribution levels of the supply chain? Please elaborate.

7. In your opinion, does the ability and threat of eligible customers to by-pass the distribution infrastructure by connecting directly to transmission infrastructure serve to place a competitive constraint on the incumbent distributor in respect of the tariffs charged and services provided on the distribution network to its customers? Please explain the reasons for your answer.

3.5. Market failures identified by industry participants

3.5.1. During individual consultations with stakeholders for the purposes of gathering information to conduct NERSA's 2019 review of the inadequacy of competition in the relevant piped-gas markets, some independent gas traders raised concerns with regard to, *inter alia*, their inability to own the infrastructure they pay for when connecting their customers to Sasol Gas' distribution infrastructure.[3] In this regard, these independent gas traders (most of whom are small or medium enterprises, or firms owned and controlled by Historically Disadvantaged Persons) submitted the following:

(i) The current situation means that they cannot reflect the distribution assets on their balance sheets. This may hamper their ability to raise financing, which may indirectly affect their ability to grow their gas operations in competition with Sasol Gas.

(ii) Sasol Gas allegedly does not prioritise the construction of independent companies' facilities to be interconnected to its distribution infrastructure. It appears that such independent companies need Sasol Gas' permission on whether it will allow them to construct distribution infrastructure within Sasol Gas' exclusive distribution areas. This leads to delays in connecting the customers of independent gas traders to Sasol Gas' distribution infrastructure, which compromises the growth and competitive opportunities of independent gas traders. It also adds unnecessary costs that are incurred by the potential customers of these independent gas traders who often have to purchase Compressed Natural Gas at a greater cost while awaiting the construction of the required infrastructure.

(iii) In addition, the processes and costs associated with connecting the potential customers of independent gas traders to the existing distribution infrastructure are not transparent, which means that they are unable to verify whether such costs were incurred efficiently. If independent gas traders have to pay costs that are unjustifiably high, then this would serve to place them at a competitive disadvantage relative to Sasol Gas. To this end, such unjustifiably high costs would serve to squeeze the profit margins of independent gas traders which, in turn, would affect the ability of those independent gas traders to grow their operations in the gas industry.

(iv) Independent gas traders connected to Sasol Gas' distribution pipeline are required to pay monopoly distribution tariffs (unregulated) that are significantly higher than that of the transmission tariffs, which adds to customers' costs. The monopolist

[3] NERSA's Reasons for Decision in determining that there is inadequate competition in the gas industry, 27 March 2019, available at:http://www.nersa.org.za/Admin/DocumentUpload/UploadFiles/Reason%20for%20decision%20-Determination%20of%20the%20inadequacy%20of%20competition%20in%20the%20piped%20gas%20industry%202018_193840122019114032.pdf

incumbent appears to be unabatedly exercising its market power in these exclusive distribution areas. The lack of compulsory third-party access and the existing regulatory gap on gas distribution tariffs exacerbate these natural monopoly outcomes.

(v) The current situation results in one firm (Sasol Gas) being able to earn profits at all levels of the gas supply chain, to the detriment of emerging independent gas traders, who cannot participate at the distribution level of the gas supply chain within Sasol Gas' exclusive distribution areas.

(vi) The period of exclusivity of 25 years on the distribution network was questioned. To this end, independent gas traders recognised the need for exclusivity in order to allow firms investing in such infrastructure to recoup their investments, but indicated that the current exclusivity period of 25 years may be too long, and unlikely to be justified on the basis of the debt tenor or capital invested into such distribution infrastructure.

(vii) In spite of the aforementioned factors, independent gas traders submitted that the lack of new gas supplies available for sale to South African customers, and the infrastructure to enable such supplies, remain the overriding factor inhibiting development and growth throughout the industry value chain, including at the distribution level.

3.5.2. Accordingly, and having regard to the factors outlined in sections 3.2, 3.3, 3.4 and 3.5 above, NERSA has a reasonable basis to suspect that certain features of the gas distribution level of the piped-gas industry value chain, as outlined above, may have the effect of impeding the achievement the following objects of the Gas Act:

(i) Section 2(a): 'promote the efficient, effective, sustainable and orderly development and operation of gas transmission, storage, distribution, liquefaction and re-gasification facilities and the provision of efficient, effective and sustainable gas transmission, storage, distribution, liquefaction, re-gasification and trading services'.

(ii) Section 2(b): 'facilitate investment in the gas industry'.

(iii) Section 2(c): 'ensure the safe, efficient, economic and environmentally responsible transmission, distribution, storage, liquefaction and re-gasification of gas'.

(iv) Section 2(d): 'promote companies in the gas industry that are owned or controlled by historically disadvantaged South Africans by means of licence conditions so as to enable them to become competitive'.

(v) Section 2(e): 'ensure that gas transmission, storage, distribution, trading, liquefaction and re-gasification services are provided on an equitable basis and that the interests and needs of all parties concerned are taken into consideration.'

(vi) Section 2(h): 'promote the development of competitive markets for gas and gas services.'

(vii) Section 2(j): 'promote access to gas in an affordable and safe manner.'

3.5.3. As such, NERSA has identified the need to conduct an inquiry in terms of section 4(d) of the Gas Act to obtain the information required by it to assess the impact of exclusive distribution areas in the South African piped-gas industry value chain on the achievement of the objects of the Gas Act. The section below sets out the envisaged scope of the inquiry.

Questions

8. What are your views regarding each of the respective market failures identified by industry participants during NERSA's 2019 review of the inadequacy of competition in the relevant piped-gas markets, as outlined in paragraph 3.5.1 above? Please elaborate.

9. Please provide your views regarding measures that could be put in place to address the respective market failures identified by industry participants during NERSA's 2019 review of the inadequacy of competition in the relevant piped-gas markets, as outlined in paragraph 3.5.1 above.

10. Are there any other features of the gas distribution level of the South African piped-gas industry value chain that may impede the achievement of the objects of the Gas Act, as outlined in paragraphs 1.3 and 3.5.2 above? Please elaborate.

4. SCOPE OF THE INQUIRY

4.1. The inquiry will seek to determine the following:

(i) The impact (both positive and negative) of the existence of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry value chain, as outlined in the previous section, on competition at each level of the piped-gas supply chain. This will serve to assess whether the aforementioned features impede or promote the achievement of the provisions of section 2(h) of the Gas Act, which seeks to: 'promote the development of competitive markets for gas and gas services'.

(ii) The impact (both positive and negative) of the existence of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry value chain, as outlined in the previous section, on investments in infrastructure at each level of the piped-gas supply chain. This will serve to assess whether the aforementioned features impede or promote the achievement of the provisions of section 2(b) of the Gas Act, which seeks to: 'facilitate investment in the gas industry'.

(iii) The impact (both positive and negative) of the existence of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry value chain, as outlined in the previous section, on the safe, efficient, economic and environmentally responsible transmission and distribution of gas. This will serve to assess whether the aforementioned features impede or promote the achievement of the provisions of section 2(c) of the Gas Act.

(iv) The impact (both positive and negative) of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry value chain, as outlined in the previous section, on the ability of companies in the gas industry that are owned or controlled by historically disadvantaged South Africans at each level of the piped-gas supply chain to grow and become competitive in the gas industry. This will serve to assess whether the aforementioned features impede or promote the achievement of the provisions of section 2(d) of the Gas Act, which seeks to: 'promote companies in the gas industry that are owned or controlled by historically disadvantaged South Africans by means of licence conditions so as to enable them to become competitive'.

(v) The impact (both positive and negative) of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry value chain, as outlined in the previous section, on the promotion of access to gas in an affordable and safe manner. This will serve to assess whether the aforementioned features impede or promote the achievement of the provisions of section 2(j) of the Gas Act, which seeks to: 'promote access to gas in an affordable and safe manner'.

(vi) The impact (both positive and negative) of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry value chain, as outlined in the previous section, on the orderly growth and development of the piped-gas industry in South Africa. This will serve to assess whether the aforementioned features impede or promote the achievement of the provisions of section 2(a) of the Gas Act, which seeks to: 'promote the efficient, effective, sustainable and orderly development and operation of gas transmission, storage, distribution, liquefaction and re-gasification facilities and the provision of efficient, effective and sustainable gas transmission, storage, distribution, liquefaction, re-gasification and trading services'.

(vii) The impact (both positive and negative) of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry value chain, as outlined in the previous section, on the achievement of the provisions of section 2(e) of the Gas Act, which seeks to: 'ensure that gas transmission, storage, distribution, trading, liquefaction and re-gasification services are provided on an equitable basis and that the interests and needs of all parties concerned are taken into consideration'.

Question

11. What are your views regarding the proposed scope of this inquiry, as outlined in paragraph 4.1 above? Please elaborate.

12. Please provide details of any other factors that should be added to expand the proposed scope of inquiry? Please provide reasons for your answer.

5. OUTCOME OF THE INQUIRY

5.1. The outcome of the inquiry will be a report on the impact of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry value chain on the achievement of the objects of the Gas Act, in line with the scope of the inquiry, as set out in the previous section. This report will be tabled at the Energy Regulator meeting and, once approved, will be published on the NERSA website.

5.2. Depending on the outcome of the assessment, the report will also make recommendations on how to mitigate any negative effects of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry value chain on the achievement of the objects of the Gas Act, as may be identified in the report.

5.3. Such recommendations may include, *inter alia:*

(i) regulatory advocacy to make policy and legislative changes that will address, or contribute to addressing, some or all of the aforementioned negative effects that may be identified in the report;

(ii) the amendment of the incumbent distribution network owner's licence conditions with the view to address, or contribute to addressing, some or all of the aforementioned negative effects that may be identified in the report; and

(iii) the initiation of an investigation into any contraventions of the Gas Act or breach of licence conditions that may be identified during the course of the inquiry.

5.4. In considering recommendations regarding policy or legislative changes, as well as any changes to licence conditions, NERSA will have due regard to approaches to addressing market failures at the distribution level of the piped-gas value chains of other countries.

5.5. In this regard, NERSA's review of policy and legislative approaches at the distribution level of the piped-gas industry value chains of countries such as the USA, Netherlands, Mexico, France, Brazil, India, Australia, Canada, UK, Poland, Russia and New Zealand has revealed the following:[4]

(i) Distribution tariffs are regulated for all countries where exclusivity in respect of distribution infrastructure exists (Netherlands, Mexico, France, Brazil, India, Australia, Canada, UK and Poland). In the USA

[4] The Library of Economics and Liberty. 2020. Natural Gas: Markets and Regulation. Available: https://www.econlib.org/library/Enc/NaturalGasMarketsandRegulation.html (Accessed: 11 September 2020); The Federal Energy Regulatory Commission (FERC) sets maximum tariffs, however, LDC are permitted to charge lower tariffs to attract business; Riemersma, B., Correljé, A.F. and Künneke, R.W., 2020. Historical developments in Dutch gas systems: Unravelling safety concerns in gas provision. *Safety science*, *121*, pp.147-157; Chambers and council. 2019. Energy: Oil and Gas 2019 – Mexico. Available: https://practiceguides.chambers.com/practice-guides/energy-oil-and-gas-2019/mexico (Accessed: 10 July 2020); Oxford Energy.2011. Long Term Natural Gas Contracts and Antitrust Law in the European Union and the United States. Available at: https://academic.oup.com/jwelb/article/4/3/260/980055 (Accessed: 13 September 2020); Lexology.2020. First Step Analysis: Gas Regulation in France. Available at:https://www.lexology.com/library/detail.aspx?g=fd2f2f72-98f6-41e4-808a-67bd6426d71e (Accessed:12 September 2020); Oil and Gas Laws and Regulation.2020. France: Oil and Gas Laws and Regulation. Available at: https://iclg.com/practice-areas/oil-and-gas-laws-and-regulations/france (Accessed:12 September 2020); The Oxford Institute for Energy Studies. 2014. Brazil: Country of the future or has its time come for natural gas?; ICLG. 2020. Brazil: Oil & gas laws and regulations 2020. Available: https://iclg.com/practice-areas/oil-and-gas-laws-and-regulations/brazil (Accessed: 26 July 2020); City Gas India Roundtable 2010: Initiatives and Challenges.2010. Available: https://journals.sagepub.com/doi/pdf/10.1177/0256090920100406 (Accessed: 07 July 2020); Wang, F., Duan, Y. and Zhou, J., 2016. China's gas market under new situations: Trends and countermeasures–Taking Sichuan and Chongqing gas provinces as an example. *Natural Gas Industry B*, *3*(3), pp.187-194; APGA. 2020. Gas facts and figures. Available: https://www.apga.org.au/gas-facts-and-figures (Accessed: 15 September 2020); Oxford Energy. 2015. Natural Gas in Canada - Oxford Institute for Energy Studies; Oil and Gas Laws and Regulations.2020. Canada: Oil and Gas Laws and Regulations. Available at:https://iclg.com/practice-areas/oil-and-gas-laws-and-regulations/canada (Accessed:13 September 2020); Taranaki Energy Forum. 2020. Oil and Gas Sector in New Zealand. Available: https://www.farm-in.co.nz/page/oil-gas-sector-new-zealand (Accessed: 15 September 2020); Gas Industry.2017. About The Industry. Available at: https://www.gasindustry.co.nz/about-the-industry/nz-gas-story/document/5806 (Accessed: 07 September 2020); OECD.2002.Reform.Available at: http://www.oecd.org/regreform/sectors/1920080.pdf (Accessed: 08 September 2020); American Public Gas Association. 2020. A Brief History of Natural Gas. Available: https://www.apga.org/apgamainsite/aboutus/facts/history-of-natural-gas (Accessed: 15 September 2020); Ofgem. 2020. Connections and competition. Available: https://www.ofgem.gov.uk/gas/distribution-networks/connections-and-competition (Accessed: 15 September 2020); IBISWorld. 2020. Gas Distribution in the UK - Market Research Report. Available: https://www.ibisworld.com/united-kingdom/market-research-reports/gas-distribution-industry/ (Accessed: 15 September 2020); Gazprom Export. 2020. Poland. Available: http://www.gazpromexport.ru/en/partners/poland/ (Accessed: 15 September 2020); Polskie Gornictwo Naftowe i Gazownictwo SA (PGNig). 2012. Distribution. Available: http://pgnig.pl/reports/annualreport2012/en/ar-dystrybucja.html (Accessed: 15 September 2020)

and Russia, distribution tariffs are regulated even though no exclusivity in respect of distribution infrastructure exists.

(ii) In all countries reviewed, third-party access to distribution infrastructure is mandatory and regulated.

(iii) Some of the countries that were reviewed allow those who paid for infrastructure to connect their customers to exclusive distribution infrastructure, to own such infrastructure (New Zealand, UK).

(iv) Some countries removed exclusivity on distribution infrastructure (USA, France, Russia, New Zealand), or reduced the period of exclusivity to a maximum of 10 years (India).

(v) Most of the countries that were reviewed that have mature piped-gas industries, had implemented some degree of vertical unbundling in their gas industries through the separation of gas supply and trading activities from that of the ownership and operation of gas infrastructure. In some instances, this includes the separation of the ownership and operation of transmission infrastructure from that of distribution infrastructure.[5]

5.6. In assessing whether any of the aforementioned approaches would be appropriate for the South African piped-gas industry, due regard will be given to the relevant differences between the structure and level of maturity of the South African piped-gas industry and the piped-gas industries of the reviewed countries.

Questions

13. Please provide your views on the degree to which each of the approaches to addressing market failures at the distribution level of the piped-gas value chains of other countries, as outlined in paragraph 5.5 above, would be appropriate for the South African piped-gas industry. Please provide reasons for your answer.

14. Please provide details of any other learnings from international best practice that would, in your view, be relevant to this inquiry. Please provide a motivation for your answer.

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[5] See Department of Energy. 2015. Natural Gas infrastructure. Available: https://www.energy.gov/sites/prod/files/2015/06/f22/Appendix%20B-%20Natural%20Gas_1.pdf (Accessed: 29 September 2020); Brattle Group. 2011. Economic Impact of the Dutch Gas Hub Strategy on the Netherlands. Available: https://www.vemw.nl/~/media/VEMW/Downloads/Public/Gas%20en%20WKK/EZ%20Gasrotonde%20Brattle%202011.ashx (Accessed: 29 September 2020); Eni. 2017. Organizations involved in the French gas market. Available: https://www.eni.com/en_FR/products-services/natural-gas/organizations-involved-french-gas-market/organizations-involved-french-gas-market.shtml (Accessed: 30 September 2020); The Oxford Institute for Energy Studies. 2014. Brazil: Country of the future or has its time come for natural gas? (Accessed 30 September 2020); Supply and trade activities are unbundled in the eastern region gas market of Australia. Available: https://www.aemc.gov.au/energy-system/gas/gas-markets (Accessed: 4 October 2020); IBIS World. 2020. Gas Supply in New Zealand - Market Research Report. Available at: https://www.ibisworld.com/nz/industry/gas-supply/301/ (Accessed: 04 October 2020); IAPG. nd. The Evolution of the Gas Industry in the UK http://www.iapg.org.ar/WGC09/admin/archivosNew/Special%20Projects/3.%20IGU%20GMI%20Guidelines/3.%20IGU%20GMI%20Guidelines%20FINAL%20-%20CD%20contents/UK%20Gas%20Market.pdf (Accessed: 4 October 2020); European Gas Hub. 2018. Benefits of Natural Gas for Poland - Needs for the Development of a Gas Hub. Available: https://www.europeangashub.com/wp-content/uploads/2018/10/Ramboll_-_Benefits_of_Natural_Gas_for_Poland_-_Main_Report.pdf (Accessed: 5 October 2020)

15. Please provide your views in respect of the parameters and factors that NERSA should consider in implementing section 21 of the Gas Act when considering the conditions of licences to owners and operators of distribution infrastructure.

16. Please provide details of any additional factors that may be considered in addressing any negative impact on the achievement of the objects of the Gas Act as a result of exclusive distribution areas, the regulatory gaps in respect of these exclusive distribution areas, and other features of the distribution level of the piped-gas industry, as outlined in this document.