



A utility operator's perspective on
 Sri Lankan Regulatory System
 Shell Gas Lanka Limited
 Workshop on Regulatory Impact Assessment 22-23/6
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Contents of the Presentation

- ❖ **Privatization of Colombo Gas**
 - Background, rationale and terms
- ❖ **Investments in the LPG Business**
 - Storage Terminal, FP modernization, Cylinders, Fleet upgrading
- ❖ **Current Market Environment**
 - Competition, Segments, Market share, potential & Growth
- ❖ **Regulatory Environment (during and after exclusive period)**
 - Pricing, Safety & Competition
- ❖ **Impacts**
- ❖ **Concluding Remarks**

Privatization of Colombo Gas

- ❖ **BACKGROUND (1995)**
 - severe shortages of cylinders, poor safety standards, importations through ships discharging gas at the port (5-6 days to discharge a ship), regular run-outs of gas.
- ❖ **GOVERNMENT RATIONALE FOR PRIVATIZATION**
 - private investment to develop infrastructure to support growing demand for LPG
 - introduce safety standards into the market
 - generate income from sale at highest possible price (open tender: Shell won with highest bid of \$30mn for 51% of Colombo Gas)
- ❖ **KEY TERMS OF THE PRIVATIZATION AGREEMENT**
 - Pricing formula linked to international prices/import costs
 - 5-year exclusive period

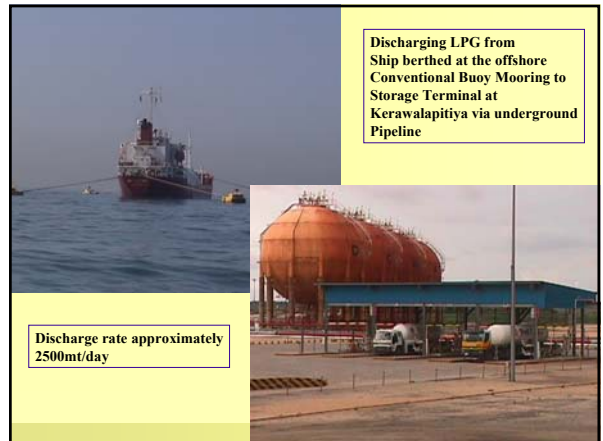
Shell's investment in LPG

- ❖ 8,000 mt (vs. min. 4,000) terminal to ensure supply to SL even during monsoons
- ❖ Automated Mabima filling plant: capacity tripled to 60,000 cylinders per day with fully automated quality control processes
- ❖ 1,200,000 new cylinders injected into the market, thus eliminating shortages completely
- ❖ New bowser fleet with full safety features
- ❖ Total investment US\$143 million *
 - * Up to 2002. Includes \$20mn write-off in 1998 due to aborted pipeline project.



Discharging LPG from Ship to Bowser inside Colombo Port
 Colombo Gas operation

Average discharge is About 450-500mt/day



Discharging LPG from Ship berthed at the offshore Conventional Buoy Mooring to Storage Terminal at Kerawalapitiya via underground Pipeline

Discharge rate approximately 2500mt/day



Current Market Environment

❖ COMPETITION

- Three main players in the market, viz, Shell Gas, Laughs Gas (entry in Q4-2001) and Mundo Gas (entry in Q2-2003).

❖ MARKET SEGMENTS

- Households (domestic LPG) - largest market segment
- Commercial (mainly food outlets)
- Industrial bulk (Ceramics, metal, large hotels, etc)
- Auto LPG

❖ MARKET SHARE, POTENTIAL AND GROWTH

- SGLL has a market share at present of around 80%
- Market penetration of domestic LPG is estimated around 25% and therefore market potential is high
- Market growth was at around 3% in 2003 and a similar growth is expected in 2004

Regulatory Environment during Exclusive Period

❖ PRIVATIZATION AGREEMENT (validity 30 years)

○ EXCLUSIVE PERIOD

- five years (1995-2000) for the LPG business

○ INVESTMENT PROGRAM

- Shell obliged to build new import terminal of min. 4,000 MT, introduce safety standards and expand the market by eliminating shortages and removing bottlenecks
- Terminal throughput charge fixed @ \$35/mt + \$1.1 per every additional cost of \$1/min above \$33/min.
- Allowed for Government equity participation in the Terminal (up to 49%)

○ PRICING DOMESTIC LPG DURING EXCLUSIVE PERIOD

- Pricing formula linked to international prices and value chain costs
- Price increases limited to 2 year up to a maximum of Rs. 25/year
- Provision to for additional price change if FOB changed by >30%
- Approval by the Secretary to the Treasury in the absence of an independent LPG Regulator

○ COMPETITION

- No other players in the LPG business during the exclusive period

❖ SAFETY STANDARDS FOR THE LPG INDUSTRY

- Developmental stage with SLSI (covering product quality, cylinder, road transport, installations, accessories)

❖ REGULATOR

- Department of Internal Trade was nominated in the absence of an Independent LPG Regulator

Regulatory Environment after Exclusive Period

❖ PRIVATIZATION AGREEMENT

- Continues to operate except specific conditions during exclusive period
- Pricing as commercially deemed fit for any LPG after exclusive period

❖ CONSUMER AFFAIRS AUTHORITY ACT No. 9 of 2003

- Establish CAA for the promotion of effective competition and protection of consumers and regulation of internal trade
- Directive authorizing cross-filling of competitor cylinders in May/03
- Domestic LPG listed as a specified good subjecting to price control

❖ SAFETY

- SLSI standards available but not legally enforceable in the absence of an independent Regulator

❖ REGULATOR

- No independent LPG Regulator appointed as yet

Impacts

❖ PRICING OF DOMESTIC LPG : PRICING REGIMES

- 2001: un-regulated, price of domestic gas was kept constant at Rs. 509/cyl throughout the year. Lobby with Govt for pricing formula
- 2002: Monthly pricing formula agreement signed with Govt. Prices varied according to the formula (agreement expired in Feb/2003)
- 2003 (Mar-Aug): un-regulated, SGLL continued to follow formula
- 2003 (Aug onwards) CAA price reviews/control – (contradict privatization agreement)

❖ COMPETITION

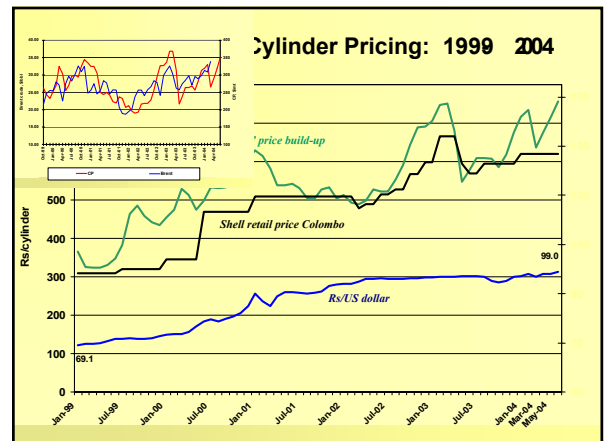
- Whilst requiring Shell to invest in a terminal that conforms to international safety standards, competitors were allowed to compromise on safety
- Price control does not provide a right incentive to foster competition which goes against the aims of CAA

❖ SAFETY

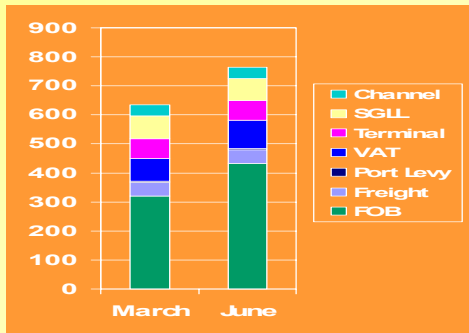
- Customer safety severely undermined with the cross-filling directive

❖ REGULATOR

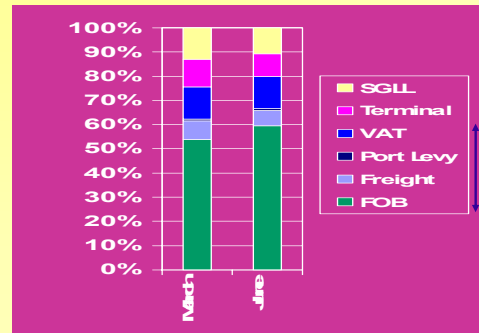
- Continued absence creates non-level playing field for existing and potential entrants to the market



Price Build



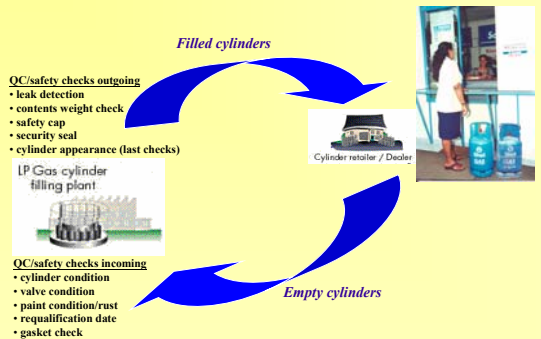
Ex-FP Price build-up (Mar & Jun-04: CAA approved)



The issue of cross-filling of cylinders

- ❖ Initiatives of Min. of Commerce/Consumer Affairs to allow filling by any player of any cylinders ("cross-filling") [CAA Directive 02/5/03]
 - Adopts concept of common cylinders; ownership of cylinders by customer
 - Favours competitors who have no investment in cylinders
 - Detrimental to brand/cylinder owners
 - Contradicts SLSI standards that require cylinder owners to take responsibility for filling, maintaining and servicing own cylinders
- ❖ Shell reaction
 - Court injunction against Mundogas on the grounds of trademark infringement (SGLL & SIPC vs. Mundogas et al)
 - Obtained court injunction against Directive; in force until final determination by Court of Appeals expected in 1st half 2004(SGLL vs. CAA et al)
 - *This initiative cannot be accepted by Shell as it infringes on its high value global brands, whilst putting Shell's reputation at risk.*
 - *We lose control over the supply chain of a product that goes into the homes of consumers and which needs tight controls to ensure its safety.*
 - *We cannot fill other cylinders owned and branded by other parties, as we would violate their property and trademark rights.*

Cylinder refilling & quality/safety controls



trademark infringement



Concluding Remarks

- ❖ The absence of an independent LPG regulator is a substantial void
- ❖ Impacts of regulations must be well evaluated before implementing