



Appropriate Regulatory Framework to Facilitate Entry of Piped Gas into the Market.

Leonardo Giacchino, Ph.D.

Presented at Energy Summit 2007

Sandton Convention Center, Johannesburg, South Africa

September 26, 2007

A Regulatory Framework for a(n almost) New Industry

- There are three stages:
 - Stage 1: Development of an industry in its infancy;
 - Stage 2: Promotion of additional growth; and
 - Stage 3: Consolidation;
- South Africa is still in Stage 1 with respect to most (developed) markets;
- The regulatory framework has to wear multiple hats:
 - Attract investments while promoting affordable and competitive prices;
 - If granting monopolies, have the necessary mechanisms in place to eliminate potential monopoly abuses and gradually introduce competition where possible;
 - Promote competition without undermining the return on and of investments of the developers of projects; and
 - Lay the ground for a developed segmented industry with the necessary procedures and price mechanisms to implement best regulatory practices.

Some Aspects of the Regulatory Framework in Discussion

- Is Open access the right principle to apply? In general yes, as long as the developers of projects do not get their investments undermined;
- How to determine the prices for natural gas? Many different theories where most of them would fail to attract demand and make the industry take off;
- How to regulate prices and tariffs? Price caps is the main choice but there are some implementation aspects that can be tricky. The Power Station effect in England;
- Should best international practice be taken into account? Yes but not only you have to be careful in selecting the examples but also analyze them deeply; and
- Other aspects might be brought up during the Session.

International Best Practice

- Many examples look great when you look at the regulatory framework in place:
 - Thoughtful about every segment (such as retail competition);
 - Open access (such as Third Party Access – TPA – a mandatory topic in the European Union);
 - Detailed tariff schemes; etc.
- However, most countries already had a state-owned industry that was privatized or had developed the industry with one or more private operators. Easy to achieve higher goals; and
- South Africa has an infant industry and should learn from successes and failures from other markets. Europe, North America or Australia does not provide these examples.

Shedding Light Using Best Practice

- Open Access is almost incompatible with the development of projects in an infant industry (you might do it for certain exceptions). But is possible after a period of time;
- Competition at the beginning only exist when developing projects that can bring natural gas to the same markets from different locations. Attracting more investments is good but beware of the “Atacama” case;
- Value pricing is best liked by companies that receive a monopoly. But there should be a clear separation of what costs and prices are for each segment in the value chain; and
- Economists talk and talk about the goodness of price regulation: price caps, yardstick competition and other theories. They want to introduce competition but the devil is in the details. Do not overlook the adoption of Network Codes: you can have the best regulatory framework in place but specific rules (such as nominations, balancing, penalties, etc.) might eliminate potential open access and competition.

Take into Account

- Remember the Revenue Requirement Standard: “Regulatory regimes in all countries and all political jurisdictions (at least those that wish to have well-functioning regulated industries) rely on a cost recovery plus investment return concept, which underlies all of the different forms of price regulation” [Lesser and Giacchino, p. 39];
- Provide the incentives for investors to develop their projects and reach potential markets but monopolies should not be granted forever (where some competition could be introduced) and put attention to the operational details;
- Open Access is a doable goal. It will come but should not be forced from the beginning; and
- Careful in under analyzing international experiences, what seem to work (in paper) in a country does not in another.



Cost Reflective Tariff Setting Approaches

Leonardo Giacchino, Ph.D.

Presented at Energy Summit 2007

Sandton Convention Center, Johannesburg, South Africa

September 26, 2007