

COURSE TITLE: RESEARCH PAPER

**RESEARCH TITLE: FUEL PRICE REGULATION; A CRITIQUE OF
THE ENERGY (PETROLEUM PRICING)
REGULATIONS 2010**

**(This research is submitted in partial fulfillment of the requirement of
a Masters in Law (LLM) degree from the University of Nairobi)**



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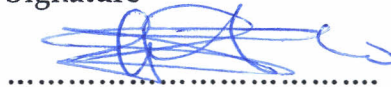
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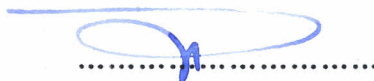
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This thesis has been submitted for examination with my approval as university supervisor.

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Date

13-11-13

Dedication

To God Almighty, my father John Paul Wangila, my mother Margaret Wangila and my dearest wife Caroline, whose selfless efforts have brought me this far. Caroline remains a huge inspiration in my life.

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I am greatly indebted to all persons who made the production of this work a success. I am specifically grateful to the following persons.

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Paul Musyimi Mangi, Edward Mulongo and the staff of Milimani High Court Library, am also profoundly grateful to them for having availed me very vital documents that have been the building blocks of this thesis, besides the courtesy extended to me while I was at the library.

Special thanks to all my classmates and college friends who encouraged me during my entire period as a student at University of Nairobi.

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7. Price control Ordinance of 16th October 1956.
8. Restrictive Trade Practices, Monopolies and Price Control Act Chapter 504 of the laws of Kenya.
9. South Africa's Central Energy Fund Act No. 38 of 1997.
10. South Africa's State Oil Fund Act.
11. The Petroleum rules, Legal Notice No. 197 of 2013.
12. Trade Licensing Act (Repealed) chapter 497 of the laws of Kenya.

GLOSSARY OF ACRONYMS

1. ADNOC: Abu Dhabi National Oil Company
2. AMEF: African Mineral and Energy Forum
3. BFP: Basic Fuel Price
4. BP: British Petroleum
5. CEF: Central Energy Fund
6. COFEK: Consumer Federation of Kenya
7. DME: Department Of Minerals and Energy
8. ERC: Energy Regulatory Commission
9. ESMAP: Energy Sector Management Assistance Program
10. FOB: Free On Board
11. GDP: Gross Domestic Product
12. KPC: Kenya Pipeline Company
13. KPRL: Kenya Petroleum Refineries Limited
14. LPG: Liquefied Petroleum Gas
15. NOCK: National Oil Corporation of Kenya
16. OTS: Open Tender System
17. RAF: Road Accident Fund
18. SA: South Africa
19. SAPIA: South African Petroleum Industry Association
20. SBC: Sales Below Cost Laws
21. USA: United States of America
22. VAT: Value Added Tax

INTRODUCTION

Governments around the world promote the growth of trade in their economies for a host of reasons but primarily trade promotes the well being of citizens in a state by creating wealth, creation of jobs, and improvement of infrastructure among many other reasons. While trade encourages the transfer of goods and services from one entity to another, there are quite a number of challenges that arise in the course of trading that if not curbed, erode the objectives trade that intends to achieve.

In the course of trade and particularly in a free market economy where there are no controls in the market, trading parties often engage in bad or unfair trade practices which may result in eroding the gains that trade is meant to achieve. Some of the practices that may result in diminishing the gains that trade is meant to achieve include; unfair competition, undercutting of prices, hoarding among others. As means of curbing some of these practices, it becomes extremely necessary that governments around the world to regulate trade (Caroline Njoroge - 2010).

Regulation of trade is a means by which a government being aware that the free market economy has certain imperfections decides to put in certain control measures particularly by way of legislation and creation of institutions so as to address the imperfections that may arise from a free market economy. The study here seeks to understand how the Kenyan government by way of legislation has sought to regulate the Energy sector but specifically the petroleum market economy by the enactment of Energy (petroleum pricing) regulations 2010 as a measure of regulating the trade in petroleum products.

The energy sector in Kenya plays a very crucial role in the process of production in Kenya and price distortions in fuel has a huge impact on other commodities that rely on fuel for their production. Petroleum products are equally used in motoring which is very critical in the movement of goods and services being produced in Kenya.

Adjustments in the price of fuel in Kenya have a direct consequence of affecting the prices of other essential goods and services being traded in Kenya. Upward adjustment of petroleum products in Kenya has a consequence of increasing the prices of other commodities that rely on some of the fuel products in the course of production.

The findings in this work will seek to show how effective the Energy (petroleum pricing) regulations 2010 have been able to regulate the price distortions in the fuel market in Kenya. Moreover the challenges that the said regulations have in their efforts to regulate petroleum products prices besides the lessons that Kenya can adopt from other jurisdictions and particularly South Africa and United States of America will equally form part of the findings of this work.

Finally and in conclusion, this work shall offer certain recommendations for law reform that maybe necessary in addressing any gaps that may be established in the regime of laws governing the regulation of fuel prices and the energy sector generally.

Kenya is totally dependent on imported crude oil for the production of petroleum products mainly from the Middle East. The political crisis that has ravaged large parts of the Middle East region in Iraq, Iran, Saudi Arabia, Yemen, Egypt and Libya occasioned high crude oil prices dating as far as 2008 and which has resulted to an increase in the prices of petroleum products¹.

The sharp increase in crude oil prices originating from the Middle East, triggered focus on the fuel prices the multi-national oil companies operating in Kenya were applying to the market. Primarily the focus on the multi-national companies is explained by the reason that the companies hold the largest market share in the petroleum industry in

¹ Katisya- Njoroge C, '*Oil and Gas: The Challenge of Protectionism in Kenya*', journal Petroleum institute of Kenya, December 2010.

Kenya, and they were considered as the entities that were applying the increased prices on the consumers. Consumers protested against the high pump prices of this vital commodity that these companies charged in circumstances perceived that the said prices not being reflective of the actual market prices.

The government of Kenya in trying to address the concerns related to the high fuel prices that were being experienced and in an effort to protect both the consumers and other stakeholders within the fuel subsector, enacted of the **Energy (Petroleum Pricing) Regulations 2010**². These regulations have the primary objective of introducing price controls in the oil industry in Kenya and the same regulations form part of the subsidiary legislation under the Energy Act No. 12 of 2006.

The introduction of the said regulations, as this study will reveal, drew sharp reactions both from the consumers and leading oil marketers in Kenya. Concerns have been raised that the said regulations overlooks, basic principles governing the law of demand and supply by imposing fuel prices that are presumed not to be indicative of the actual cost of supply³.

Further, questions have also been raised as to whether the said law really serves the oil sector in Kenya and this study will suggestions to improve the said law with a view of making it friendlier to the business concerns of the various stakeholders.

This study will critically analyze the said regulations with a view of pointing out its in impact on the oil industry as well as suggesting reforms in the said law in areas that govern the pricing of petroleum products in Kenya

² Legal notice 196 of 2010.

³ Energy regulatory commission paper on petroleum pricing regulations 2010

Background to the problem

The Kenyan economy underwent major structural reforms since early 1990's with a view to improving the overall macro-economic efficiency, increase incomes, create employment opportunities and improve the performance and productivity of investments. These reforms included abolition of price controls through the repeal of the price control part within the Restrictive Trade Practices, monopolies and price control Act and allowing the market forces of demand and supply to determine prices and resource allocation⁴.

In line with these public sector reforms, the Kenyan government deregulated the petroleum market operations. These reforms included liberalization of distribution and pricing of petroleum products and a partial liberalization of product supply. Other reforms included the abolition of the National Oil Corporation of Kenya crude oil supply quota, liberalization of transportation modes, legalization of minimum operational stocks and introduction of suspended duty on refined products imported directly into the country to cushion the refinery from competition from efficient refineries in the gulf region. The reforms highlighted here were achieved largely through the repeal of the Petroleum Act which was the legislation that previously put in place a lot of governmental control in the operations within the petroleum industry in Kenya.

Despite the deregulation above herein, it was observed that the post deregulation era, retail prices of petroleum products did not closely follow changes in the International oil prices. Infact most oil companies were quick to adjust retail petroleum prices upwards when international oil prices are rising and were slow to lower prices when oil

⁴ ibid

prices were falling. These sharp increases in prices continued to cause serious concerns with the public insisting that oil marketers were exploiting Kenyans⁵.

The behavior of the oil marketing companies generated a lot of public concerns in the overall economic efficiency and rationale of unfettered market mechanisms, in the retail petroleum market in Kenya. These concerns re-kindled agitation for the re-introduction of price controls.

Against this background, the Ministry of Energy through the Energy Regulatory Commission was tasked to develop a formula for regulating petroleum prices which was reduced to legislation by the Energy (Petroleum Pricing) Regulation 2010. It is these regulations that are now in existence, that various stakeholders within the oil industry have put to doubt about their efficiency and suggestions have been made on ways the regulations can be improved to serve the wider interest of the Kenyan public. With the sharp increases in fuel prices, concern have been raised in whose interest does the new petroleum pricing law serve. Various interest groups seem uncertain if the regulations have effectively regulated the oil industry as initially anticipated.

Statement of the problem

The Energy (petroleum pricing) Regulations 2010 cannot effectively regulate the pricing and supply of petroleum products in Kenya.

Justification of the Study

The critique of the Energy (petroleum pricing regulations) 2010 is an important legal academic study for the reason that this law was enacted to regulate one of the most important sectors of the Kenyan economy. The petroleum industry is a key component of the energy sector in Kenya and any legislative enactments affecting/regulating the

⁵ Same as note 4

pricing of fuel has a direct impact on many other sectors of the economy that rely on fuel to operate.

Considering that petroleum products are utilized both in motoring and industrial use, any price changes whether regulated or not has a huge impact on the cost of production and movement of any goods or services.

The introduction of the Energy (petroleum pricing) regulations 2010 generated a lot of public debate as to the efficacy of the said regulations to guarantee consumers and dealers the actual prices for fuel products. In order to broaden a deeper understanding of the said regulations and how they do apply, this study is necessary so to broaden that understanding and also contribute to the wealth of legal knowledge in this area that a lot has not been published on it.

Theoretical Framework

The regulation of trade by law such as the case by the Energy (petroleum pricing) regulations 2010 in relation to the pricing and supply of fuel products in Kenya can be well explained by the interaction of the market and the distribution of legal rights that is a critical component of the study of law and economics.

Arising from these studies of law and economics was the **Coase Theory** that was developed by **Ronald Coase** in, *"The Problem of Social Cost"*, 3 *Journal of Law and Economics* (1960). *The Firm, the Market and Law* (University of Chicago Press, Chicago 1988 - pp 156)⁶.

Under the Coase theory, efficiency in the free market is an interaction of supply, demand and costs leading to equilibrium at a particular level of supply and price.

⁶ Brian Bix, jurisprudence: theory and context, 3rd edition Thomson sweet and Maxwell pg 195

Effort will be made in this work to have a closer look at the fuel formula established by the Energy (petroleum pricing) regulations 2010. Keen assessment and scrutiny will be given by this work to the specific regulations and cost drivers that the formula relies on to regulate fuel price as a way of giving a more detailed and academic understanding of the subject rather than the general and quasi academic discussions currently available.

George Wachira in, *'Why petroleum price control is justified?' Business daily, 24th January 2010*, is of the view that, the formula for determining fuel price is based on establishing and obtaining consensus on what constitutes a reasonable rate of return on investment for oil marketers and other supply chain stakeholders such as service stations and transporters. He further states that the formula enshrined by the Energy (petroleum pricing) regulations 2010 is fair, transparent, prompt, and predictable and generally meets the aspirations of investors and provides consumers assurance.

In as much as Wachira may be partly right in his analogy of the said law, his rather simplistic and skewed acceptance that the law is appropriate for all the stakeholders sounds naïve in the absence of a critique on the law putting in place price controls in the petroleum industry. For these reasons the aim of this work will be to give sharp focus to the regulations themselves and practically the manner in which help achieve the whole aspect of regulation of price and supply of petroleum products.

This study will re-examine some of the studies previously carried in this area, (though relatively new) with a view of broadening the scope of knowledge relating to existing laws governing the oil industry in Kenya and in particular the regulation bringing to effect price controls in the Petroleum Industry in Kenya.

The study will mainly identify the gaps that the said laws have in so far as regulating the oil industry is concerned and propose areas for law reform and government policy that will enhance growth and proper regulation in the oil sub-sector in Kenya.

Objectives of the Research

Main objective

To evaluate the efficiency and impact of the Energy (petroleum pricing) regulations 2010 to regulate the pricing and supply of petroleum fuel products in Kenya.

Specific Objectives

1. To identify the cost factors applicable in determining the price of petroleum products.
2. To identify the gaps unaddressed by the Energy (petroleum pricing) 2010 regulations to regulate the Oil Industry in Kenya.
3. To identify other jurisdictions where Kenya can adopt best practices in so far as the subject of fuel price regulation is concerned.
4. To recommend areas for law reform in the legislation governing the Oil Industry Kenya.

Hypothesis

1. The introduction of price controls in the petroleum industry in Kenya has failed to protect both consumers and marketers of the oil commodity.

2. The Energy (Petroleum Pricing) regulations 2010 are a failed attempt to tame oil marketers profiteering schemes.

Research questions to be answered?

1. How has the introduction of price controls in the oil industry impacted on the development of the sector?
2. What governmental actions are necessary to enhance the development of the oil industry in Kenya?
3. What law reforms are necessary to be put in place to catalyze the sustainable growth of the oil industry in Kenya?

Methodology

The overall objective of this assignment is to evaluate the efficiency of the Energy (petroleum pricing) regulations 2010 in so far as regulating the price of petroleum products is concerned. The methodology to be used in collecting data shall include for this work shall include research in libraries for relevant books and articles that may cover this topic. Use of the internet and interviews with persons who are well versed with the happenings within the fuel subsector will to a large extent also contribute to the data necessary for the building blocks of this study.

Finally, where applicable it may be necessary to apply the use of questionnaires and interview schedules as means of getting the divergent views on this subject. The study

is likely to combine both primary and secondary sources as a means of collecting data necessary for discharging the primary objective of this work.

Scope of the study.

The study undertaken here relates mainly on the Energy (petroleum pricing) regulations 2010 which is a legislative enactment for purposes regulating trade in the energy sector. At the outset, the work shall confine itself to a brief introduction on the history of trade regulation in Kenya, its origins and specifically why there arose a need to regulate the pricing of fuel in the petroleum subsector in Kenya.

Importantly there shall be an analysis of the Energy (petroleum pricing) regulations 2010 and particularly the formulae established under the regulation which is the main law that is mandated to regulate the pricing of fuel in Kenya. An assessment of whether the said law has been able to achieve its objectives and the shortcomings that have arisen as a consequence of applying the said law will also be given attention.

The study shall also look into the impact that the law on fuel price regulation has had on the Kenyan economy at large as well as the lessons that Kenya can draw from the South African case study relating to the regulation of fuel prices by law.

Finally this work shall also give recommendations on possible areas for improvement on the law and government policy so as to address the concerns that have arisen as a result of applying the Energy (petroleum pricing) regulations 2010 as a means of regulating the fuel prices applicable in Kenya.

Limitations of the study

The Energy (petroleum pricing) regulations 2010 are a relatively new enactment in Kenya and there is very little available legal literature on these regulations. For this reason, most of the contributions adopted in this study have to a great extent been that from industry players and consumers as apparently legal discourse on the same

is very limited. Reliance on government publications and interviews from industry players have also been used in helping to arrive at some of the conclusion made in the work. Therefore the positions taken on the regulations in some of the publications may be partisan to the extent that they intend to advance government agenda and that of the stakeholders in question.

The absence of detailed legal literature on the regulations has hampered an incisive critique on some of the issues under discussion but this notwithstanding, sufficient effort has been to undertake a legal critique of the regulations in this work. Despite the limitations faced, this work has taken the initiative to commence serious legal discourse on the subject and it is hoped that other legal scholars shall take up the challenge and address other key areas that this work may have failed to address in the critique of Energy (petroleum pricing) regulations 2010

Chapter breakdown

Chapter 1

An Introduction to a Historical overview of Trade Regulation in Kenya

This chapter gives a historical insight generally of trade regulation in Kenya since the pre- independence period and time thereafter. It highlights the strategies the Kenyan government has been putting in place over the years to regulate trade. The chapter finally introduces the subject of fuel price regulation in Kenya and the brief history behind the enactment of the Energy (petroleum pricing) regulations.

Chapter 2

Evaluating the Energy (Petroleum Pricing) Regulations 2010

The chapter makes an effort to break down the Energy (petroleum pricing) regulations highlighting the various components that the regulations comprise of. Different elements that make up the price of fuel are discussed in this chapter in relation to the fuel formula established by the regulations. Brief discussions on the

rationale behind the inclusion of these elements in the fuel formula are also discussed at great length in this chapter.

Chapter 3

Impact of Energy (Petroleum Pricing) Regulations 2010 on the Kenyan Economy

The chapter deals with the effects of applying the Energy (petroleum pricing) regulations 2010 on the Kenyan economy. An account of how the regulations have impacted on fuel pricing, supply and also the economy at large is given so as to bring out the extent to which the regulations have served the consuming public. The positives and negatives that relate to the formula have been brought out in the chapter so as to broadly appreciate what the fuel pricing have to offer in a wider context.

Chapter 4

Regulation of Fuel Price in Other Jurisdictions

In this chapter details are given on how fuel price is regulated in other jurisdictions. Specific reference is given to petroleum price regulation in South Africa and the United States of America. There is also an assessment of how of how the price of fuel is arrived at in these jurisdictions and a comparison is given with that of Kenya. The nature of legislation and workings of some of the institutions that regulate fuel price in these countries is also captured so as to make appropriate comparisons with the Kenyan situation that is under discussion in this work.

Chapter 5

Recommendations & Conclusion

This part of the work proceeds to give suggestions that may as well be of great importance in trying to address some of the gaps that the Energy (petroleum pricing) regulations 2010 have left unaddressed. Possible areas for law reform are suggested so as to provide a platform for improving the whole regime governing the management of fuel pricing and supply in Kenya.

In conclusion this work will serve to increase knowledge in this relatively new area of study. Common knowledge will attest to the fact that a critique on Energy regulations (petroleum pricing) 2010 and their impact to the petroleum industry in Kenya, is an area that does not have wide academic discourse. The attempt made here to give an academic discussion on these regulations is hoped will encourage more individuals to delve into further research on the subject with aim of finding better and more efficient ways to manage the pricing of petroleum products. The work in this thesis is expected to serve as a starting point to future scholars and other persons with an interest on this virgin subject, accomplish the task of investigating how best trade in fuel products can be regulated through effective pricing mechanisms.

CHAPTER 1

1.1 A Historical overview of Trade Regulation in Kenya

Prior to Kenya's attainment of self rule in June 1963 and full independence on 12th December 1963, the level of Industrialization and liberalization of the Kenyan economy was very low as compared to the robust growth that is presently evident in the various sectors of the economy. Most consumer items and basic essential commodities needed by the settler community were imported from the United Kingdom in support of Her Majesty's motherland¹. The interests of the consuming settlers were protected through a price control regime that regulated trade at the time and which ensured that consumers of essential goods were not exploited by businessmen². The said regime at the time was the form of governmental intervention that gave some measure of regulation price regulation on the essential commodities.

At the dawn of independence, Kenya embarked on a process of rapid industrialization and indigenization of the economy. These efforts were achieved through the setting up of import substitution industries to meet Kenyan and East African Community requirements. Premised on the fact that Kenya was just an emerging economy, there was firm protection of the infant industries by government at the time as a means of ensuring their growth. Imposition of high tariffs and import duty was a policy that was pursued at the time to discourage over reliance on imports and regulate trade in imports. Simultaneously with these efforts, there was the transfer of non-citizens firms to Kenyans, which essentially came to effect with the enactment by the independence administration of Kenya the Trade Licensing Act³ which denied trade licenses to certain trades and businesses.

¹ Peter Njoroge Muchoki, *"Enforcement of Competition Policy and law in Kenya, including case studies in the areas of Mergers and Takeovers, prevention of possible future abuse of Dominance and collusion/price fixing"* page 3 in a paper presented at the 3rd annual competition conference on 3rd September 2010 in South Africa.

² Price Control Ordinance of 16th October 1956

³ Chapter 497 of the Laws of Kenya which was legislation enacted to regulate ownership of business.

Briefly, therefore the commercial activities in Kenya were regulated mainly through instruments provided under the Price Control Act⁴, Trade Licensing Act⁵ and Imports, Exports and Essential Supplies Act⁶ among others. Under the price control Act, measures such as the fixing of prices of certain essential goods were put in place to regulate the trade of essential goods such as food stuffs and alcoholic beverages.

The Trade Licensing Act (now repealed) similarly utilized instruments to account for the registration of businesses transferred from the settler community that was leaving Kenya to indigenous Kenyans. The act regulated persons conducting certain trades and also sought to know the nationality of persons in a particular trade as a means of giving due advantage to indigenous Kenyans in business.

Establishment of imports substitution industries as well as regulating the licensing Imports and Export were some of the instruments employed under the Imports and Exports and Essential Supplies Act as part of the avenues to regulate commercial activities. The strategies herein reflect the extent of involvement by the state to control business activities of its subjects and with time as the market grew into the larger East African community it became necessary to address new challenges that were arising.

The East African Community was the principal market for most of the goods that were being produced and traded in Kenya. Vegetable oils, refined oil products, tobacco, tea and alcoholic drinks were some of the goods that originated from the Kenya economy for export to the East African community⁷. Following the collapse of the community in the mid 1970's, the industries in Kenya as a result of a shrunk market could not compete in the export markets as a consequence of their high prices, low quality and poor

⁴ Ibid note 2

⁵ Ibid note 3

⁶ Chapter 502 of the Laws of Kenya.

⁷ The East African "Kenya's export growth slowing down- new study" editorial 7th August 2008

packaging for most of the products⁸. The state of affairs obtaining at the time resulted in falling employment opportunities and living standards occasioned by the challenges aforementioned⁹.

In order to reverse the trend of economic decline that was being experienced at the time, it became extremely necessary that Kenyan industries must produce not only for the domestic market but also to some extent for the export market. The government in the mid 1980's and early 1990's decided to expose the Kenyan Industries to competition in the domestic market by allowing some imports so as to prepare them for export market competition¹⁰.

Competing imports were selectively allowed into the Kenyan market; items that were previously banned, were progressively removed from the list of banned items and price controlled items removed from price control lists progressively. In addition many businesses became licensed to boost domestic competition, lower consumer prices, increase employment opportunities and improve efficiency in the use and allocation of scarce resources to competing needs.

The petroleum sector was among the sectors that the government of the Republic of Kenya opened up for competition. In achieving this objective the government through parliament repealed the former petroleum act¹¹ which was an act of parliament to make provision for restricting and regulating the importation, transport and storage of petroleum. The repeal took effect with the enactment of the Energy act.¹²

⁸ Ibid note 1

⁹ Ibid note 1

¹⁰ *Enactment of the Restrictive Trade Practices, Monopolies and Price Control Act- Chapter 504 of the Laws of Kenya on 23rd December 1988. However over the years this piece of legislation was repealed and particularly the section on price control which was repealed in the year 2003.*

¹¹ Chapter 116 of the laws of Kenya

¹² Act no. 12 of 2006

Previously the sector was largely dominated and run by few foreign multinational companies that had set base in Kenya. However with the policy that had now been adopted by government, there was an increased presence of new oil companies registered and trading in the products locally¹³. At around the same time, the government purposed to enhance the activities of the National Oil Corporation which provided a platform for the government to also participate in the trade within this sector¹⁴.

Premised on the fact that petroleum products are used throughout the entire Kenyan economy, it may have been apparent that stimulating economic competition in this sector of the economy may as well achieve the object of increasing overall competition, lower consumer prices, increase employment opportunities and improve efficiency in the use and allocation of scarce resources to competing needs in the entire economy¹⁵.

Gasoline and diesel are primary fuels used in road transport. Oil is used in power generation and accounts for 11% of total electricity generated in Kenya. Adequate and reliable transport services and electricity are essential for economic development. On the other hand, households use a variety of Petroleum Products, Kerosene for lighting, cooking and heating water; liquefied petroleum gas (LPG) for cooking and heating and gasoline and diesel for private vehicles as well as power generation¹⁶.

Prices users pay for these petroleum products have macroeconomic and microeconomic consequence. At the macroeconomic level, oil price levels can affect the balance of

¹³Carolyn Njoroge, "Oil and Gas: The Challenges of Protectionism in Kenya" Business Daily, 4th March 2009.

¹⁴ National Oil Company of Kenya website. www.nockenya.co.ke see http://en.wikipedia.org/wiki/National_Oil_Corporation_of_Kenya as at 29th April 2013

¹⁵ Institute of Economic Affairs Journal-Kenya, "Examining the rationale and effects of petroleum pricing regulations in Kenya", February 2011.

¹⁶ *ibid* note 13

payments, gross domestic product (GDP), and where fuel prices are subsidized, government budgets, contingent liabilities or both¹⁷.

At the microeconomic level, higher oil prices lower effective household incomes. This follows as households pay more for petroleum products they consume directly. Higher oil prices on the other hand increase the cost of other goods that have oil as an intermediate input. The most significant among them for the poor in Kenya is food, on which the poor spend a significant amount on their expenditure – often exceeding 50% of their expenditure. Food prices increase because of higher transport costs and higher prices of such inputs to agriculture as fertilizers and diesel to operate farm machinery and irrigation pumps. For the urban poor who use public transport, higher transport cost also decrease the effective income¹⁸.

Kenya is totally dependent on imported crude oil primarily sourced from the Middle East, which is subsequently refined to produce petroleum products such as diesel, petrol, kerosene, jet fuel, liquefied petroleum gas and lubricants¹⁹. These products are extremely important as they directly affect almost the entire Kenyan populace on a daily basis in their various uses and there is critical need to lay an understanding of certain critical factors relating to this sector such as the price, supply and importantly the laws governing the subsector.

The political crisis exemplified by calls for regime change in large parts of the Middle East region in Iraq, Yemen, Tunisia, Egypt, Syria, Sudan, South Sudan, Iran and Libya has resulted in disruptive and unstable crude oil prices in Kenya dating back to the period between 2008 and 2011. Civil unrest has largely weakened the economies of these oil rich producing nations to the point where these countries main export which is

¹⁷ Oil and Gas Journal 2009, "Petroleum Markets in Sub-Saharan Africa" December- 2009-12

¹⁸ Ibid note 12

¹⁹ ESMAP. 2005a. "The Impact of Higher Oil prices on low income countries and on the poor." Report 299/05. Washington DC: World Bank.

oil has suffered and is now characterized by low production resulting to shortage in supply to their markets²⁰. Against the backdrop of reduced supplies in the international oil market and the forces of supply and demand in play, the consequence has been increased oil prices being passed to the companies that trade in the commodity in the world markets to some extent²¹.

The petroleum Industry in Kenya is largely dominated by multi-national companies majority of whom are foreign owned. As a consequence of the high oil prices, that was being experienced in the period immediately preceding the year 2010, the dominance of the multi-national companies operating in Kenya was brought under sharp focus as consumers protested against the high pump prices of this vital commodity that the oil companies are charging despite indications that the said prices were not reflective of the actual market prices. For instance, in June 2011 according to information available to the oil industry in Kenya, it cost kshs 15 to transport one litre per kilometer using the big haulage companies yet transport and delivery was pegged at kshs 7.50 by the formula the newly introduced petroleum pricing formula²².

Arising from the presumptive concerns that oil firms were exploiting consumers, the Kenyan government was under exceeding pressure from a number of consumer lobby groups to regulate the pricing of petroleum products being marketed in Kenya²³. The concerns here were being raised premised on the belief that majority of the oil companies had taken into increasing the prices given the reason that the shortage that was being occasioned by the civil unrest in some of the countries already mentioned

²⁰ Political crisis in the Middle East Arab nations has been occasioned by an increased activism by nationals of those countries to press for regime change that have been viewed oppressive to the concerns of the citizens.

²¹ Bacon, Robert and Masami Kojima, 2008. Coping with Oil Price Volatility. ESMAP. Energy Security Special Report 005/08. Washington D.C. World bank.

²² Jimmy Mugerwa- Kenya Shell country manager(leading oil marketer) giving his opinion to the subject of the new energy regulations on petroleum pricing at a workshop organized by the Energy regulatory commission in Mombasa April 2011.

²³ Consumer federation of Kenya position paper at Kenya Oil sector conference held at Panafric hotel on 19th November 2008.

herein. Whereas this could have true, there was also a divergent view that not at all times these unrests had a bearing on the international oil prices. There were periods of relative calm in some of these countries and yet the prices of oil did not seem to come down raising doubts on the former view²⁴.

In the year 2010, the Kenyan government through the then existing Energy Act²⁵ and in an effort to try and address the concerns of what were seen as high petroleum prices, enacted the *Energy (Petroleum Pricing) Regulations 2010*²⁶ under the said Energy act. The regulations had the primary objective regulating the trade in petroleum products and particularly to fix the maximum wholesale and retail pump prices of petroleum products²⁷. Petroleum products prices had for a long time been above the 100 shillings mark and way beyond the prices previously being enjoyed. Despite the enactment and coming into force of these regulations which were intended to check fuel prices, there are still complaints that the said regulations have not addressed the concerns that led to their enactment necessitating a critique on their efficacy²⁸.

The introduction of the said regulations has drawn sharp reactions both from the consumers and leading oil marketers in Kenya. Premised on the view that the law is founded on a presumptive formula, concerns have been raised that the Energy (Petroleum Pricing) Regulations 2010 overlook basic principles governing the law of demand and supply and therefore has a consequence of hurting the business of individuals by imposing presumptive prices not indicative of the actual cost of supply²⁹. This will become clear, in the next chapters, where this study will critically analyse the formula in question.

²⁴ Ibid note 18

²⁵ Act No 12 of 2006

²⁶ Legal notice 196 of 2010

²⁷ See regulation 4 of the Energy (petroleum pricing) regulations 2010.

²⁸ Institute of Economic Affairs Journal-Kenya, "Examining the rationale and effects of petroleum pricing regulations in Kenya", February 2011.

²⁹ Ibid note 21

1.2 Why regulate pricing within the petroleum subsector

The Kenyan Economy as has been mentioned before has undergone structural reforms since the early 1990's particularly in the area of transforming its market to be a free one. The state has had a hand in the past in determining the prices of essential goods without much regard to the forces of demand and supply³⁰. Over a period of time there have been efforts by the state to have a departure from this position³¹.

These reforms have had the aim of improving macro-economic efficiency, increase incomes, create employment opportunities and improve the performance of the economy. The reforms initiated by the state included the abolition of price controls to allow the market prices of demand and supply to determine the prices of essential commodities³².

As part of the reforms that the economy underwent, the Kenyan government deregulated the petroleum market. Under these reforms, the distribution and pricing of petroleum products was to be entirely determined by market prices. The National Oil Corporation of Kenya, Crude Oil supply quota was abolished and there was the Liberalization of transport modes among other reforms which this paper will highlight. These reforms were largely achieved through the repeal of the Kenya Petroleum Act, which had previously put restriction on some of the practices³³.

³⁰ Beginning the late 1980's and early 1990's, the Government of Kenya undertook various structural adjustment policies aimed at achieving macro-economic stabilization that would see Kenya return to viable economic trajectory. This was mainly through the introduction of Price control legislation such as the Restrictive Trade Practices, Monopolies and Price Control Act. The Act was a transitional measure to ensure gradual state withdrawal in the market.

³¹ The price control part of the Restrictive Trade Practices, Monopolies and Price Control Act has since been repealed by the Government.

³² Ibid note 23

³³ Kenya Petroleum Act – chapter 116 of the laws of Kenya

The common view was with a free market, competition was going to be enhanced which would have had the net result of improving the quality of products as a result of the competition and a reduction in the retail prices.³⁴

Despite the introduction of the reforms within the petroleum industry, retail prices of the petroleum products seemed not affected by the said changes. Infact even at a time when prices of crude oil at the international market were significantly low (100 dollars per barrel) to translate to lower retail prices locally, the petroleum market in Kenya defied all market fundamentals to have the prices above Kenyan shillings 100 per litre.³⁵

The observation made was that oil companies were quick to adjust retail petroleum pump prices upwards when international oil prices were rising and were slow to lower their pump prices when oil prices were falling in the international market. The sharp increases in the prices continued to cause concerns with the public viewing the conduct of the oil marketers as exploitative, which resulted to the agitation for the re-introduction of price controls within the oil industry sub-sector³⁶.

The determination of fuel prices by use of market forces above here appears to have failed to meet the expectations of most consumers necessitating the state to enact the regulations under discussion. In my assessment, the main reason for the failure to have market forces of demand and supply sufficiently address the concerns of most consumers is that the fuel product in Kenya is imported as the country is yet to start producing its own oil. Therefore the aspect of supply mainly is one that is the hands of external powers and the domestic market in Kenya has absolutely no control over the availability of the product and all challenges that go together with having the supply of crude oil and its related products availed to our market.

³⁴ Ibid note 20

³⁵ Consumer federation of Kenya position paper 2011, citing that fuel price regime enshrined in the ERC regulations on petroleum pricing have failed to curb rising oil prices.

³⁶ Ibid note 27

Additionally, the petroleum subsector is part and parcel of the energy sector and this sector plays a very crucial role in the overall economy performance of other sectors. Common knowledge and experience in Kenya is that any adjustment in prices falling within the energy sector has a net effect of also affecting other sectors of the economy. Allowing fuel prices to regulate singly by use of market forces without any measure of governmental control would be subjecting other sectors of the economy to the risk of serious distortion knowing very well that the pricing of the commodity is to a large extent determined by external forces.

Following the public outcry that the fuel prices were hurting the vast majority of its consumers, the Ministry of Energy through the Energy Regulating Commission developed a formula that had the sole purpose of regulating petroleum product prices. This formula was reduced to legislation and is now the Energy (Petroleum Pricing) Regulations 2010³⁷.

In conclusion the formula created by the regulations was an effort to introduce regulation within the petroleum subsector in Kenya. Reliance on market forces to regulate the prices of petroleum products appears not to have been effective as Kenya to a large extent imports all fuel products from foreign jurisdictions. On account of this reason, it is obvious that the for instance the aspect of the supply levels of the commodity are not within the control of market forces within Kenya and if the state fails to have such an issue addressed, it will consequently hurt the consuming public.

Under these regulations, the government effectively introduced price caps for oil products as the next chapter will reveal. Concerns have been raised on the said formula that it does not address the market expectations which is to have oil products retailing at actual market rates, guarantee constant supply of the commodities in the market and ensure the profitability of the fuel business is guaranteed. Further in the chapters that

³⁷ Legal notice no. 156 of 2010

follow here, it will be necessary to establish if this form of regulation by the new law stifles competition among the oil companies. A free market enterprise or economy encourages competition as a basis of promoting the well being of both the business entities and the consuming public.

Prior to having a closer look at how the Energy (petroleum pricing) Regulations have impacted on the question of trade regulation and particularly that of petroleum products, next chapter will critically analyse the Energy (Petroleum Pricing) Regulation 2010 formula and whether indeed it has been effective to regulate the petroleum industry in Kenya.

CHAPTER 2

2.0 EVALUATING ENERGY (PETROLEUM PRICING) REGULATIONS 2010

Faced with the need to regulate, the prices of petroleum products being traded in the Kenyan market, the Kenyan government in the year 2010 came up with regulations under the Energy Act No. 12 of 2006 as an answer to putting into check fuel prices of oil products which were viewed to be beyond the reach of many consumers³⁸.

As opposed to the determination of prices in a free market economy, where demand and supply of a commodity dictates what will be the price of an item in the market. The Energy (Petroleum Pricing) Regulations 2010 express a formula for the determination of both wholesale and retail prices for certain specific petroleum products³⁹.

“Under Regulation 3 of the Energy (Petroleum Pricing) Regulations 2010

There is established formula for determining the maximum wholesale and retail pump prices of petroleum products at a wholesale depot and at a retail dispensing site.”

The formula as established under the regulations herein consists of factors described in regulation 4 of the Energy (Petroleum Pricing) Regulations 2010. The factors highlighted by this regulation enumerate the maximum wholesale and retail pump price of petroleum products which a person carrying on petroleum business shall sell at a wholesale depot and at retail dispensing site.

Regulation 3(ii) clearly spells out criminal sanctions for any individual convicted of an offence committed under these regulations and any person found liable shall pay a fine not exceeding one million shillings or the withdrawal of the operating license or both. In other words where an oil dealer prices the petroleum product at a rate higher than

³⁸ In the exercise of the powers conferred by section 102 of the Energy Act number 12 of 2006, the minister of energy is by the said section empowered to make such regulations that in effect determined the maximum wholesale and retail prices of various petroleum commodities.

³⁹ Regulation 3(i) of the Energy (petroleum pricing) regulations 2010.

that provided under the formula they will suffer criminal sanctions as spelt out in regulation 3 above.

Under regulation 4(a) of legal notice 156 of 2010 being the Energy (petroleum pricing) regulations, the maximum wholesale and retail pump prices of petroleum products in shillings per litre shall be determined taking into account the following factors respectively. For wholesale prices for Super petrol, Regular petrol and Kerosene it will be the sum total of the weighted average cost in shillings per litre of the product in the Kenya Petroleum Refineries Limited (KPRL) and in Kipevu Oil Storage Facility (KOSF), pipeline tariff from Mombasa to the nearest wholesale depot as per the Schedule applicable, Allowed pipeline losses provided at 0.25%, Allowed oil marketing company's gross wholesale margin which shall be Kshs 6.00 per litre, and allowed losses in the depot set out in the second schedule of the regulations at 0.50%.

In respect of Automotive Diesel, regulation 4(a) ii provides the maximum whole sale price shall be the sum total of weighted average cost in shillings per litre in the Kenya Petroleum Refineries Limited (KPRL) and in Kipevu Oil Storage Facility (KOSF), pipeline tariff from Mombasa to the nearest wholesale depot as per the schedule applicable, allowed pipeline losses provided at 0.25%, allowed oil marketing company's gross wholesale margin which shall be Kshs 6.00 per litre and allowed losses in the depot set 0.30%.

In so far as the retail the retail pump prices are concerned regulation 4(b) I provides the maximum retail price for Super petrol, Regular petrol and Kerosene shall be the sum total of the following factors; Maximum wholesale price for Super Petrol, Regular Petrol and Kerosene, Allowed retail dealers gross margin which shall be Kshs 3.20 per litre inclusive of station losses and delivery rate from the nearest wholesale depot to a retail

dispensing site in shillings per litre which shall be as set out in the schedule on maximum margins applicable at any given time.

Regulation 4(b) ii provides for the maximum retail price for Automotive diesel which shall be the sum total of the following factors; Maximum wholesale price for Automotive Diesel, Allowed retail dealers gross margin which shall be Kshs 3.20 per litre inclusive of station losses and delivery rate from the nearest wholesale depot to a retail dispensing site in shillings per litre which shall be as set out in the third schedule on maximum margins.

Regulation 4 equally demonstrates how the weighted average cost in shillings per litre in the Kenya Petroleum Refineries Limited and in Kipevu Oil Storage Facility is arrived and this cost calculated from the following set of factors that include; the average volume of the refined petroleum products imported through the open tender system in the previous three months in litres, the average unit cost of the refined petroleum products imported through the open tender system in the previous three calendar months in shillings per litre, the average volume of the petroleum products obtained from crude refined at KPRL in the previous three calendar months in litres, average unit cost of petroleum products obtained from crude refined at KPRL in the previous three calendar months in shillings per litre, total taxes and levies for petroleum products in shillings per litre, Excise Duty, Road Maintenance Levy, Petroleum Development Levy, Petroleum Regulation Levy, Kenya Oil Storage Facility charges which shall be $\$3/M^3 + VAT$ at 16% and Suspended Duty which shall be Kshs 0.45/litre.

The unit cost of imported refined petroleum product shall be determined in accordance with the calculation used in the open tender system for importation of petroleum products and shall in terms of regulation 5 be the actual landed cost of crude plus

refinery fees for the month's crude imports allocated to the refinery products yields benchmarked to the cost of importation of the same refined products.

Regulation 6 under the legal notice being discussed here mandates the commission in its sole discretion to determine the refinery fees and Kenya Oil Storage Facility charges which raises a lot of questions the basis employed in the determination of these charges if the same is only left to the commission.

Commission under regulation 10 may review the calculation of the maximum wholesale retail pump price of petroleum products determined under Regulation 4 of these Regulations as and when it may deem fit for purposes of monitoring compliance. The Minister may review the formula mentioned under Regulation 4 of these Regulations as and when he may deem fit."

In developing the formula the Energy Regulation Commission (ERC) requested for views from the public and the various stakeholders within the oil industry on the efficiency of the formula to address the concerns of the unprecedented price levels⁴⁰.

According to the regulations formulated by Energy Regulatory Commission the price formula is gazetted monthly, on what ought to be the prices of oil products wholesaling and/or retailing within a given calendar month. The gazetted prices are primarily based on petroleum supply chain logistics and their cost implications factors on downstream prices which are analysed here⁴¹.

⁴⁰ Energy regulatory commission held a session on 14th November 2008 with the various stakeholders in the oil marketing sector in Kenya and came up with a paper that sought to address the various issues that these groups had wanted addressed by regulations.

⁴¹ Regulation 3(v) of the energy(petroleum pricing) regulations 2010

Further, the ERC's position is that in coming up with the oil price legislation formula it aimed at guaranteeing the consumers the fairest market prices for the products and at the same time allow the dealers to recover the actual costs incurred and provide reasonable returns on investments⁴².

The following factors as captured in regulation 3 of the Energy (petroleum pricing) regulations 2010 were considered in the discussions that led to developing the formula that now seems very contentious in light of the fact that fuel prices seem to continue rising unabated even despite the coming into force the formula enacted with sole aim of checking fuel prices as a means regulating trade in petroleum products⁴³.

2.1 Cost Drivers

According to the Energy Regulatory Commission there is the firm opinion that recovery of cost drivers actually incurred in the supply chain is critical in the petroleum pricing formula⁴⁴. An analysis of these cost drivers has to be done right from the point at which petroleum products are sourced.

The demand for petroleum products in Kenya is met through two ways the first one being Importation of crude oil and refining the same at the Kenya Petroleum Refineries Limited in Mombasa which portion provides about 50% of the total demand of petroleum products for use in Kenya. Importation of refined petroleum products is the second means by which the demand for petroleum products in Kenya meets the other 50% balance of the demand⁴⁵. In arriving at the cost of petroleum products it will be necessary to examine the various components that inform the price of fuel as determined under both ways. By having this examination it will make it clearer while

⁴²Justus Onderi and Kennedy Senelwa, "hope for motorists as ministry publishes rules on fuel pricing", Business Daily 6th December 2010.

⁴³Energy regulatory commission paper on petroleum pricing regulations 2010. Page 1.

⁴⁴ Ibid note 35 page 2

⁴⁵ Ibid note 6 page 3

giving a critique of the regulations under discussion in this work whether the energy (petroleum pricing) regulations 2010 as enacted can achieve the purpose for which they were enacted.

Crude oil in Kenya is imported through an Open Tender System (OTS)⁴⁶, which is coordinated by the Ministry of Energy. Licensed importers of petroleum products are required by law to participate in the crude oil processing tender through legal notice no. 197 of 2nd December 2003⁴⁷. Under this arrangement, the Kenya Petroleum Refineries Limited is protected through a minimum base load, processing of 1.6 millions tones of crude oil per year which meets about 50% of the total petroleum demand. The licensed importers share this base load on a prorated basis to their market shares⁴⁸.

The balance 50% of the demand is met through importation of refined products. The Ministry of Energy coordinates another OTS for importation of 35% of refined products in which again all licensed companies are entitled to participate. The balance of 15% the companies are allowed to import on their own outside the tender requirements⁴⁹.

2.2 Costing of Crude Oil

According to the Energy Regulatory Commission, crude oil is traded openly in the International markets. Kenya's crude imports are made up of 90% Urban Crude Oil marketed by Abu Dhabi National Oil Company (ADNOC). Each month ADNOC sets the official selling price of crude oil lifted during the previous month⁵⁰. The price fixed

⁴⁶ This is a procurement system that requires an oil marketer to bid for the supply requirements for the entire market. For an oil company to participate in the open tender system, it must be licensed and meet the conditions set by the Energy Regulatory Commission. The successful bidder then imports and sells the product to the other oil companies as per their market share. The quality and quantity of products and their pricing is closely monitored by the Ministry of Energy

⁴⁷ Section 31A of the petroleum rules.

⁴⁸ Ibid note 35

⁴⁹ Ibid

⁵⁰ Ibid

by ADNOC becomes the free on board (FOB)⁵¹ loading port price applicable to the tenders called in Kenya.

Premised on the fact that Kenya Importation of crude oil is by an OTS, tenderers quote a fixed freight and premium figure to bring the crude oil from the loading port to Mombasa. Other costs that comprise the landed costs of the crude delivered to the refinery at Mombasa include⁵²freight charges for delivering the crude to Mombasa where the refinery is, marine and war insurance, Import declaration form, letter of credit charge, ocean loss allowance, port handling charges, Importer administration fees, VAT discharge inspection fee, demurrage and cargo charges.

The system applied in respect of imported crude is clearly beyond the control of the Energy regulatory commission as the commission has absolutely no control over what transpires in so far as setting the official price of the Abu Dhabi National Oil company for the sale of crude oil. Furthermore, the fact that the Energy regulatory commission has no control over the foreign exchange rates particularly the United States dollars that ordinarily apply in the course of trade at the international market the costing of the crude is largely determined by external forces not within the control ERC and the regulations there under.

2.3 Costing of Refined Petroleum Products

In so far as costing of the imported refined petroleum product is concerned, the ERC paper on petroleum pricing regulations highlights the following;

⁵¹ A mercantile – contract term allocating the rights and duties of the buyer and the seller of goods with respect to delivery, payment, and risk of loss, whereby the seller must clear the goods for export and the buyer must arrange for transportation. The buyer is responsible for all the costs of carriage.

⁵² Energy regulatory commission paper on petroleum pricing regulations page 4

Estimated prices for refined petroleum products are available on daily basis in such publications as Platt's and Reuters for the major markets⁵³. Imports to Kenya, relevant prices are those obtained in the Arabian Gulf. Quotations for trading are based on the mean prices for 3 – 5 days around the bill lading day as the free on board price plus freight and premium component⁵⁴.

It follows therefore that for purposes of the OTS for the refined products also, tenderers quote a fixed freight and premium figure to bring the specific product from the loading port to Mombasa. Other components of the final landed costs of the refined petroleum products but almost similar to the costs of the landed costs of crude include⁵⁵: free on board price, freight and premium, marine & war insurance, import declaration form fee, letter of credit charges, port handling charges, CIF import administration fees, discharge inspection fee, demurrage and cargo clearing charges.

Synonymous to the system applied in respect of imported crude, the final landing price of refined petroleum products is equally beyond the control of the Energy regulatory commission just as it is with the case relating to imported crude. ERC has absolutely no control on setting the official price for the sale of refined petroleum product purchased abroad. Furthermore and just as is the case with crude, the fact that the Energy regulatory commission has no control over the foreign exchange rates, makes the costing of the refined petroleum largely determined by external forces not within the control of the regulations thereunder. The lack of control here puts in doubt the extent of price regulation envisaged by energy regulations under discussion in this work.

In arriving at the final landed cost, the rate at which the Kenyan shilling trades against the dollar has an impact on the final landed cost of this product. It is a requirement of the open tender system to specify the dollar rate applicable at the time of tendering. The

⁵³ Ibid note 44

⁵⁴ Ibid note 44 at page 6

⁵⁵ See regulation 3 of the ERC regulations (petroleum pricing) 2010.

challenge therefore is, by adopting the use of a foreign currency that the ERC has no control, it becomes exceedingly difficult to state that the passed on to the dealers and consumers comprises the actual cost of the petroleum products. Below is a further assessment of the various components of the price factor enshrined in the fuel pricing formula.⁵⁶

2.3.1 Refinery Processing Cost

As a further component of the final price that petroleum products will trade at, is the cost of refining the crude and which is also incorporated in the cost.

Once the crude has landed, the corporation has to pay a refinery fee to Kenya Petroleum Refineries Limited (KPRL) for processing the crude to final products. Data available indicates that the correct average processing fee is United States dollars 2.4 per barrel (approximately Kshs. 1.20 per litre). The figures given here vary depending on the monthly gazetted prices of the energy regulatory commission.

The refinery also uses 5% of the crude as fuel and loss in its operations. This loss in light of the current petroleum pricing formula has to be recovered in the pricing mechanism generated in the formula⁵⁷.

2.3.2 Storage costs

The Kipevu oil storage facility is the government of Kenya owned import tank for refined products. It is managed/operated by the Kenya Pipeline Company. The charge for using the said facility is about Kshs. 0.28 per litre plus VAT⁵⁸. Premised on the fact there is limited berthing space at Kipevu oil terminal in Mombasa, tankers wait for long periods and thus introducing demurrage charges into the cost of the fuel.

⁵⁶ Regulation 8 petroleum pricing 2010

⁵⁷ Regulation 7 petroleum pricing 2010

⁵⁸ Storage costs as at December 2011 which figure varies depending on the costs incurred at Kipevu oil terminal. The figure shown source is from ERC.

Systemic inefficiencies of the oil terminal have also occasioned the regulations to consider this factor in the price formula⁵⁹. In my view the prices arrived here are not the actual costs of the fuel products as it includes a cost factor extraneous to the supply and distribution of the fuel products.

2.3.3 Transportation Costs

The price formula envisages and is alive to the fact that the petroleum products are transported either by road or pipeline⁶⁰.

Kenya Pipeline Company owns and operates petroleum products from Mombasa to Nairobi, and onward to Nakuru, Kisumu and Eldoret. The pipeline company currently charges Kshs. 1.53 per litre plus VAT from Nairobi to Mombasa. The transport and storage contracts between Kenya Pipeline Company and Oil Marketing Companies provide for a maximum operational loss allowance of 0.25% value⁶¹.

The use of road transport from Mombasa to Nairobi, Western Kenya and other neighbouring counties has been occasioned by the liability despite the expansions by the Kenya Pipeline Company to meet market demands. Road transport is more costly with the result of increasing fuel prices in fare fixing countries.

2.3.4 Distribution Depots Costs

In Nairobi and Mombasa, Kenya Pipeline Company and Kenya Petroleum Refineries Limited do not have depot facilities for loading delivery trucks. Instead therefore in these towns petroleum products are pumped into depots belonging to the oil marketing companies⁶². Under the Energy (Petroleum Pricing) Regulations the marketing

⁵⁹ Angela O. "Why big companies are exiting Africa's oil retailing Business" Business daily 22nd June 2011.

⁶⁰ Regulation 4 petroleum pricing 2010.

⁶¹ Energy regulatory commission July 2011 published rates.

⁶² Ibid note 44

companies have been allowed to include their operational costs to a maximum of 0.5%⁶³. The cost is prorated amongst the marketing companies and eventually included in the final price that retails for the petroleum products.

Finally the Energy (petroleum pricing) 2010 regulations also take into account of the profit margins that ought to apply both at the wholesale market and retail market. The legislation gives the maximum amount of money in Kenya shillings the wholesalers and retail outlets can make per litre of oil product sold⁶⁴.

The pricing of petroleum products in Kenya currently, is pegged on the various matters some of which are already discussed herein.

2.4 Does the fuel formula under the regulations protect the consuming public?

Bearing in mind that the price formula developed by the energy regulations, has to factor all the components highlighted herein, it is necessary to analyze if indeed, the benefits of such protectionism as seen in such price control mechanisms of the sector can be passed to consumers and other stakeholders in the industry in light of the factors herein. Does the formula as envisaged guarantee the consuming public to pay for actual costs of petroleum products? The discussions that follow hereunder will analyse if indeed the cost factors under the regulations are correctly employed to ensure that the consuming public only pay for the actual fuel prices. In establishing whether the fuel formula serves the purpose for which they were enacted an analysis will be done on some of the cost factors under the regulations.

There is a view that the prices of petroleum products currently gazetted by the regulations in Kenya are not reflective of the actual costs incurred to supply petroleum commodities. To a large extent, the prices are inclusive of components that are

⁶³See regulation 4 petroleum pricing regulations 2010

⁶⁴Regulation 4a and 4b at schedule 3 of the regulations.

completely unnecessary in the costing of oil and this have largely pushed up the prices. If that happens, then it would imply that the regulations are not protecting the consumers but may as well be serving other subservient interests. Presumably allowing prices of petroleum products to be determined entirely by forces of demand and supply, the concerns being raised about the regulations would probably not have there⁶⁵.

The formula embraced by the Energy Regulatory Commission, affixes certain percentages on all the factors affecting the final price of petroleum products yet it is common knowledge that ERC has no control over a majority of the components that determine the fuel prices. Primarily ERC cannot effectively call itself a regulator when most of the cost factors it seems to affix are not within its control⁶⁶. Clearly the insurance premiums, freight charges, refinery costs, pipeline costs among others are not within the control of ERC and hence there can be no firm claim of regulation that ERC can assert. In other words the figures published monthly as constituting the actual cost of petroleum products are presumptive and in my view cannot be a basis for any meaningful regulation for the reason that most of the cost factors and largely determined externally.

Price controls under the said regulations therefore it may be observed are not real and they are likely to hurt both the consumers and marketers if the mode of application of these regulations remains the same. A practical look at the inability of the formula to address the petroleum market prices is demonstrated by the following assessment of the price components.

⁶⁵ Angela O. "why big oil companies are exiting Africa's oil retailing business" Business Daily opinion 22nd June 2011 published in the petroleum institute journal.

⁶⁶ Ibid note 56

2.5.0 Free on Board Price (FOB)

The Energy Regulating Commission relies on the monthly set price of the Abu Dhabi National Oil Company Price as a basis of determining the Free on Board price of fuel monthly⁶⁷. There is absolutely no clear basis why FOB price is pegged on the said company price and yet there is the likelihood that other international companies could as well offer prices that are more competitive than ADNOC⁶⁸.

By adopting an unclear basis on the FOB price, it therefore follows that the regulations maybe as well be condemning the Kenyan market to an FOB price that is entirely dictated by a single source. An oil marketer who is able to source the crude from a cheaper source may as well quote their FOB price as that of ADNOC when in actual fact the price from where the crude is being sourced maybe much lower⁶⁹. In South Africa, the FOB price of fuel is not single sourced as will be established in the subsequent chapters but it is an average of fuel from several destination that provide crude oil for importation.

The result here is that, the marketer proceeds to reap unfairly from the consumers as they are obliged to sell at prices already fixed by ERC failure which their license may be withdrawn and heavy fines imposed on them⁷⁰. From the assessment here, it is crystal clear that the regulations may not necessarily be offering the best price available but what is entirely dictated by the demands of the formula. Therefore the single sourcing that normally under the open tender system for the procurement of crude oil in Kenya does not offer any measure of protection to consumers by affording them the best and fairest price of fuel but that availed from Abu Dhabi National Oil Company Price which is not necessarily the best. Further there is no clear basis why it had to be this particular

⁶⁷Caroline Katisya Njoroge company secretary Kenya petroleum refineries limited, "Oil and gas- the challenge of protectionism in Kenya" Business daily opinion 2009.

⁶⁸ Ibid note 58

⁶⁹Rida Elamir- Oil Libya managing director giving an opinion in a correspondence to the Energy Regulatory Commission.

⁷⁰Regulation 3(iv) petroleum pricing regulations 2010.

company and this obscurity raises doubts as to whether there is any measure of protection under the fuel formula.

2.5.1 Maritime & War Insurance Cost

Presently the ERC (Petroleum Pricing) regulations have for instance affixed a rate of 0.0998% of the free on board price in respect of Insurance component part of the final landed cost of crude oil⁷¹. However this figure varies depending on the quote given for the imported crude oil by the successful bidder in the open tender system for sourcing the crude.

It is common knowledge that marine insurance is offered by various private companies whom the oil dealers are at liberty to negotiate their own premiums with the said companies. Where an importer has been able to obtain a fair premium on the insurance applicable while transporting the crude oil in a free market and where such premiums are not regulated such benefits are usually passed on to the consumers. As a result of the competition oil marketers will purpose to offer the lowest possible prices as a way of increasing the volumes of their sales and which in effect guarantees affordable prices to the public.

Unfortunately the regulations as presently enacted provides an incentive to importers to always rely on the maximum rate provided by the regulator as a basis of arriving at the final landed cost of the crude oil. From the foregoing it is clearly evident that by the regulations affixing the maximum rate applicable on insurance on the basis of the successful quote given in the open tender system, it hinders consumers from getting the benefits of low premiums.

The aforementioned failure by the regulations is further worsened by the fact that the OTS (Open Tender System) works in such a way that the successful bidder in any given

⁷¹ July 2012 according to rates published by the Energy Regulatory commission

period of crude oil importation to a large extent determines what would be the applicable final landed price⁷². In my view, the successful bidder individual and private bargains on the insurance premiums, letter of credit charges, freight charges etc, will heavily determine the final landed prices of petroleum products.

From the above, the question that beckons is whether the formulae offers any measure of protection to consumers in so far as the cost factor on maritime insurance is concerned? The answer is a resounding no and this is premised on the fact that ERC has no ability to regulate maritime insurance premiums for overseas corporations. The rate affixed by the regulations therefore, is to a large extent obscure as no clear basis has been laid in the regulations to demonstrate how it is arrived at. Absence of clarity in the manner in which the formulae arrives at the rate for maritime insurance on the cost of imported crude oil casts doubt that the regulations in so far as this aspect is concerned do protect consumers to ensure that they pay for the actual cost of the crude delivered to Mombasa.

2.5.2 Refinery costs

Presently the Energy (Petroleum Pricing) Regulation provides an average processing fee of approximately Kshs. 1.20 per litre of crude oil as at July 2012. Further it is also provided that the refinery at Mombasa uses 5% of the crude as fuel and loss in its operations. The regulations formula is enacted in such a way that the losses incurred at the refinery have to be recovered in the pricing formula mechanisms of petroleum products⁷³. In applying this formula so as to cushion refinery losses in the pricing mechanisms of the regulations, consumers as well as the dealers are subjected to defray incidental costs that do not form part of the actual costs of the fuel and this is a departure from the intentions of the regulations under discussion.

⁷² Section 31A of the petroleum rules, Legal Notice No. 197 of 2003

⁷³ Regulation 5 petroleum pricing 2010.

The KPRL is 50% state owned by the government of Kenya⁷⁴. In a study coordinated in relation to domestic refineries, it has been found that a refinery that takes less than 100,000 barrels a day is not economically viable. Part of the problem with the refinery at Mombasa is that it operates below its full capacity which is 60,000 barrels per day, which is largely to blame for the losses that the refinery makes⁷⁵. With such reduced capacity, the prospects of profitability of such a refinery are diminished and hence the unnecessary increase in the price of fuel. The refinery operates below its installed capacity due to water shortages and power outages which in fact prompted the government to instruct the management of the refinery to put mechanisms in place for generating its own power⁷⁶.

In order to ensure that the refinery continues being economically viable the petroleum pricing regulations, have provided the sum of Kshs. 1.20 per litre of fuel to be factored in the formula in order to cancel the losses being made at the refinery. In my view I find this is an unnecessary component to be factored into the cost of fuel. The net effect of this position by the regulations is that, the final price of petrol per litre is inclusive of a component that is largely outside what ought to determine the price of fuel.

There is absolutely no sound basis why consumers and other key stakeholders of petroleum industry in Kenya such as the oil marketing firms should be compelled to pay for the losses of an inefficiently run state corporation⁷⁷. Questions will obviously abound on whether it is still necessary for the state to burden the taxpayer by owning such a loss making facility.

⁷⁴ Kenya petroleum refineries limited website. <http://www.kprl.co.ke/profile.php> on 26th July 2012

⁷⁵ Oil and Gas journal 2009, petronews info KPRL 2010.

⁷⁶ Hon. Kiraitu Muriungi- Minister for Energy Kenya being quoted in the Daily Nation, November 2009.

⁷⁷ Kenol/Kobil has been pursuing an expansionist strategy beyond controlled business unit. New price ceilings set in an effort to protect consumers have shaved off the profits of oil dealers significantly. Marketers are concerned that the formula for setting price caps does not cover all operating costs, infrastructure costs and the negative effects of system inefficiencies such as the losses incurred during the refining process.

Alternatively it may also be necessary to explore ways in which to improve the capacity and operations of the refinery in order to curb the losses incurred at the facility and being passed on to the consuming public and the oil marketers.

By the state having a sizeable stake in the refinery, the marketers and the public are forced to absorb costs that are not relevant in the petroleum pricing mechanisms. The inclusion of the loss element in the price of petroleum products is in my view completely unnecessary in the pricing mechanism of fuel products and should be a consideration in answering the questions that may abound here. Borrowing practices from other jurisdictions in respect of ownership of refineries may as well do away with such unnecessary expenses being passed to the various stakeholders in the industry as the said expenses do not comprise actual costs of petroleum products⁷⁸.

Kenya Petroleum Refinery Limited (KPRL) just like many other state-owned enterprises faces its own special challenges. Achieving sound operational and financial performance by the refinery highly depends on the ability of KPRL to be commercially focused with clear objectives, an appropriate governance structure and adequate human and financial resources to fulfill its mandate. Like many other state-owned enterprises KPRL faces budget constraints and is less likely to pursue efficiency improvement aggressively.

Clearly from the foregoing by the regulations loading on to consumers the cost of the inefficiencies occasioned by the state enterprises in the cost of fuel price is entirely unfair and is a further demonstration that the regulations have failed to ensure that consumers of petroleum products only pay for actual costs incurred in the delivery of these products.

⁷⁸ In South Africa two refineries are entirely privately owned-(source- 2008b, "Refining crude oil- Part 2" petroleum sector Briefing Note no. 10 World Bank site sources 2011.

The inclusion of such factors also unnecessarily undermines the profitability of the oil marketing firms, not to mention that the Kenyan consumer and the oil marketers are tax payers and are separately taxed to finance the operations of these state enterprises. Judicial notice should be taken of the fact that any price affixed on the cost factors of crude will eventually be paid for by the consuming public and an inclusion of an unnecessary cost in price fuel is an unnecessary burden and goes outside the intentions of the formulae under the Energy (petroleum pricing) regulations 2010 which was to ensure consumers pay for actual cost of fuel. Any strategies outside these intentions by the regulations will be serving subservient interests and not that of protecting the consuming public.

2.5.3 Transportation and Pipeline costs of fuel

The Energy (Petroleum Pricing) Regulations 2010, just as with refinery costs, has affixed a maximum rate on the price of fuel per litre the component of transportation via pipeline⁷⁹. Currently the regulations have affixed Kshs. 1.53 per litre plus VAT on the price of fuel as the portion that governs pipeline costs. The pipeline in Kenya is state owned and is run by the Kenya Pipeline Company. The Kenya Pipeline Company and Oil Marketing companies provide for a maximum operational loss allowance of 0.25%⁸⁰ volume which loss is factored in the pricing mechanisms generated by the Energy regulating commission regulations.

The losses that arise in the cause of using the pipeline are attributed to the fact that the pipeline for a long time operated at only 50% of its capacity, partly because of erratic power supply. Undertaking pipeline repairs also reduces the volume of petrol products transported. This is because during the said repairs the entire line has to be shut to

⁷⁹ See regulation 4a and 4b of the formula. Pipe line transportation costs are factored in arriving at the maximum retail and wholesale price.

⁸⁰ Ibid note 4b

facilitate the repairs. When this happens, oil marketers are compelled to switch to trucking which is slower considering that some roads are in poor condition.

The regulations by affixing a rate on the component of pipeline costs when some of the pipeline costs are occasioned by system inefficiencies, does more harm than good to the final pump prices that oil marketers and consumers have to pay. The slow rate at which products are pumped occasions delays resulting in shortages that is characterized by recent long queues seen at fuel stations across the country.

From the discussions herein it is evident that despite the regulations being aimed to protect both the marketers and consumers, this objective is unlikely to be achieved as the inefficiencies within the system make it difficult to pass the benefit of fuel prices that are a true reflection of the costs incurred in importation, processing and transportation to the final consumers. I have observed that since the introduction of the price controls by the regulations herein in 2010, the prices of fuel have largely remained above the Kshs. 110 mark.

Interestingly this is happening even despite the gains made by the Kenya shilling against the foreign currencies such as the dollar that is the currency of choice in the trade at the international market. The inefficiency occasioned within the pricing mechanisms employed by the regulations has eroded any benefits that would have been passed to the various stakeholders in the oil market.

2.5.4 Profit Margins between Wholesalers and Retailers

The Petroleum Pricing Regulations in a bid to also control the profit margins of both wholesale marketers and retail marketers of the petroleum products has affixed a maximum margins that maybe enjoyed by the dealers in the industry at both levels. The formula allows the oil marketing company's gross wholesale margin at Kshs. 6.00

per litre and that for retail dealers at Kshs. 3.20 per litre⁸¹. This manner of regulating the wholesale and retail oil marketing companies is completely out of touch with the actual realities of the oil business.

By the regulations affixing maximum margins by the dealers, it fails to appreciate that the operational costs of the dealers vary and may well exceed the margins already fixed by statute. The Petroleum Institute of Kenya has attributed the closure and exodus of some of the petroleum companies to other markets to the requirement affixing maximum margins to the oil companies.

Oil companies such as Chevron, Caltex, Esso, Mobil among other, sold their business interest in Kenya and relocated to other countries citing excessive interference by the state in the operations of their businesses⁸². State interference here could be construed to include the enactment of legislation that pre-determines the profit margins of private business entities.

Such mechanisms scare away investors and do not serve to promote the overall efficiency of the sector. For instance Total Kenya Limited has continued to raise concerns that the performance of the company continues to be adversely affected by the current economic environment that has witnessed sharp increase in interest rates on bank borrowings, high inflation rate and depreciation of the Kenya shilling against major world currencies. These challenges add to the unfavourable market conditions facing the oil industry in Kenya such as the impact of price controls within the petroleum sector that were introduced in December 2010, but whose formula has not

⁸¹ Ibid note 70

⁸² Angela Owiye. "why big oil companies are exiting Africa's oil retailing business" Business Daily opinion 22nd June 2011 published in the petroleum institute journal.

been recognizing the deterioration of the macroeconomic environment completely erodes any gain by most businesses⁸³.

Going by the analysis of the cost factors in the pricing of petroleum products as envisaged by the formula, it is clear that the formula falls short in meeting the objective intended.

In conclusion, there are doubts that the formula under the regulations does give the actual cost of petroleum products. From the analysis it is evidently clear that there are glaring gaps in the formulation of the regulations so as to ensure dealers and the consuming public pay for the fairest price for fuel products. The lack of capacity by the regulations to have any measure of control on the external factors such as cost of crude oil from abroad, freight charges, insurance among others raises doubts on whether there is any meaningful price regulation on fuel products. Furthermore the inclusion of factors such pipeline losses, refinery losses, Kipevu storage facility losses is also an unnecessary burden to the consuming public and there is absolutely no basis for to have such costs reflected on the actual cost of petroleum products. Numerous complaints that have been raised from the application of the regulations are attributed to the gaps mentioned here. From the foregoing it is apparent that the consuming public which ultimately pays for the fuel prices seems not to be getting any meaningful protection from the formula under the regulations. The next chapters shall now look at the impact of then Energy (petroleum pricing) regulations 2010 on the Kenyan economy alongside lessons that Kenya can learn from other jurisdiction that employ price caps legislation in their oil sectors.

⁸³ Comments from the management- Alexis Vovk Managing Director- Total Kenya during the presentation of the unaudited third quarter results for the period ended 30th September 2011

CHAPTER 3

3.0 IMPACT OF ENERGY (PETROLEUM PRICING) REGULATIONS 2010 ON THE KENYAN ECONOMY

This chapter will seek to investigate to what extent have the energy (petroleum pricing) regulations affected the well being of the Kenyan economy as well as interrogating the effectiveness if at all any that these regulations have brought about in the capping of fuel prices. In beginning to examine these issues a brief general overview of the economic environment in Kenya will suffice at this stage.

Kenya's macro-economic environment continues to undergo significant reforms since the mid 1980's and which are aimed at improving economic performance, attract investment, increase employment opportunities and incomes and improve the productivity and efficiency of public investments.⁸⁴ As discussed in the previous chapter, the reforms included privatization by the government, liberalization of commodity prices and exchange rate regimes, withdrawal of the public sector in activities of a commercial nature among others.

In tandem with reforms in other sectors of the economy, the government has undertaken structural reforms in the commercial segments of the energy sector, namely electricity and petroleum, with a view to improving the operational efficiency in the sector by eliminating distortions that existed hitherto, induce competition and allow energy prices to move in consonance with market fundamentals and attract investment to the sector.⁸⁵

As Kenya aspires to be a middle income economy as envisaged in Vision 2030, it faces an enormous task of meeting energy needs due to high expectations in growth to power

⁸⁴ Kenya Institute of Public Policy Research and Analysis (KIPRA) Report –Comprehensive Study and Analysis on Energy Consumption Patterns in Kenya-July 2011-Page 6.

⁸⁵ Ibid note 84

the economy. The country therefore needs to come up with strategies and investment plans to secure sustainable supply of energy to meet the growing demand. The energy sector is considered a key enabler to achieving Vision 2030⁸⁶. Electricity, renewable energy and petroleum are the most potential subsectors. Petroleum and electricity are the most dominating fuels in the commercial sector.⁸⁷

Premised on the finding that petroleum subsector remains one of the sectors that has immense potential in the Kenyan economy, it remains extremely necessary that any strategies employed in the sector must remain practical so as to achieve this objective. The Energy (Petroleum Pricing) Regulations 2010, in their application, have had several impacts in the Kenyan economy and which fact brings to focus, whether the objects intended in the said regulations will help in the achievement of the Vision 2030.

The fuel formula captioned by the Energy Regulations and already discussed in the earlier chapter regulates the prices of petroleum prices through price capping. The prices of Super, Regular, Automotive Diesel and Kerosene have their prices reviewed on a monthly basis by the Energy Regulatory Commission.⁸⁸ The regulations on fuel price capping took effect from December, 2010⁸⁹ after the public, consumer rights groups and members of parliament became incensed due to what was perceived as rising food and energy costs which were all attributed to the high cost of petroleum products.⁹⁰

Perceived increased cost of petroleum prices was attributed to the increased cost of living that was unbearable to the majority of Kenyans and particularly those with low incomes.⁹¹ With the introduction of the Energy (Petroleum Pricing) Regulations 2010

⁸⁶ Ibid note 84

⁸⁷ Ibid note 84

⁸⁸ Regulation 3(3) The Energy (Petroleum Pricing) Regulations 2010

⁸⁹ Legal Notice No 196-Energy Act No 12 of 2006

⁹⁰ Institute of Economic Affairs Journal- "Excusing the Rationale and Effects of Petroleum Pricing Regulations in Kenya" - February 2011

⁹¹ Ibid note 89

the government appeared to be doing its prime duty of protecting citizens from exploitation by “*bourgeoisie* oil marketers”.⁹² The petroleum prices would now be set based on the cost of imported product, logistical costs, a set wholesale and retail margin and the same would be effective from 15th of a month until the 14th of the following month, in line with the new legal regulations. As a consequence of the application of these regulations within the Kenyan market, numerous concerns have been raised and which are discussed hereunder as some of the impacts of the coming into force of the Energy (Petroleum Pricing) Regulations 2010:

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3.1 Reduced Profitability in the Oil Retailing Business.

With the implementation of the Energy (Petroleum Pricing) Regulations 2010, there are observations that it has given rise to reduced profit margins, increased competition and the price caps partly explains the reduced uptake of business by some oil companies out of the Kenyan market as they shift focus to more lucrative exploration and production activities.⁹³

The coming into force of the aforementioned regulations has been attributed to the business decisions that some of the companies are currently making to cease operations in this market. Anglo-Dutch giant Shell in the year 2011 concluded a divestiture deal from its core markets in Africa, becoming the most recent oil marketer to exit Kenya. The actions of Shell were basically following in the footsteps of its predecessors that had left the country over dwindling margins.⁹⁴

The departure was among the latest in a string of departures by global oil brands from the African Petroleum market in recent years. Others include Caltex (Chevron), British Petroleum (BP), Mobil, Agip and Esso which companies it is acknowledged here left the

⁹² Eugene Obiero, “Is Regulation of Fuel Price Good for Kenya,” Business Daily- 17th June 2012

⁹³ Ibid note 92

⁹⁴ Angela Owiye “Why Big Companies are Exiting Africa’s Oil Retailing Business,” Business Daily 22nd June 2011

fuel retailing business in Kenya prior to the enactment of the petroleum pricing regulations.

Shell is currently exiting from all African operating markets-except Egypt and South Africa, as well as ceasing some exploration activities.⁹⁵ Company sources⁹⁶ at Shell indicate that they intend to retain a very small stake in the fuel business as they have very little appetite for downstream oil marketing. In fact the operations of Shell in Kenya are currently under an exclusive licensee Vivo Energy limited which company continues to carry the business under the Shell brand when in actual fact Shell has ceased operations in Kenya. The corporate identity of the company trading as Shell is Vivo Energy limited but the brand remains intact. Essentially this was done by Vivo energy while acquiring Shell in order to utilize the good reputation that Shell had in the market⁹⁷.

Kenya has as many as 50 licensed oil marketing companies, but just about six of them control 86% of the market.⁹⁸ These are Total Kenya, Kenol Kobil, Shell (now Vivo Energy Limited), Oil Libya, Gapco and National Oil. Among the two largest investment firms with a foothold in the Kenyan market Kenol Kobil and Total Kenya, only the later has continued to expand its downstream marketing presence.⁹⁹ Total Kenya which increased its network after merging with Chevron's Kenya operation in 2009, leased some of its Stations to National Oil to reduce its dominance in the Kenyan Market.¹⁰⁰

Whereas it is possible that other reasons could have attributed to the exodus of some of the oil companies from the Kenyan market, it is not in doubt that the said exodus has to

⁹⁵ Ibid note 92

⁹⁶ Jimmy Mugerwa, Kenya Shell Country Manager- 2011

⁹⁷ Christian Chammas- Vivo Energy Limited chief executive officer in an article "Kenya Shell now becomes Vivo energy", the Standard, 7th February 2013.

⁹⁸ Ibid note 92

⁹⁹ Total Kenya continues to demonstrate presence in the retailing market even while majority of the large companies have scaled down their business. The acquisition of numerous stations that were formally owned by Caltex Oil is a major pointer.

¹⁰⁰ Ibid note 92

some extent been attributed to the price caps ceilings that the Energy (Petroleum Pricing) Regulations 2010 formula has put in place that has greatly reduced profitability of the business.¹⁰¹ One cannot wish away the fact that the oil firms are operating in this market with a view of ensuring that their businesses remain profitable.

Marketers are particularly concerned that the Energy (Petroleum Pricing) Regulations 2010 formula does not cover all operating costs, infrastructure costs and the negative effects of system inefficiencies.¹⁰² For instance, Kenol Kobil has been pursuing an expansion strategy beyond the controlled business unit. In other words the company is putting further investment on the infrastructure that supports the business and yet the regulations do not seem to appreciate such costs. The new price ceilings set by the formula in an effort to protect consumers, have shaved off the profits of oil dealers significantly.¹⁰³

Observations have been made that the refining cost provided by the formula is not sufficient¹⁰⁴. Routine refinery production inefficiencies, imports handling, and demurrage costs pile pressure on the price of fuel with subsequent effects on the economy¹⁰⁵. The oil marketers believe that the price ceilings by the formula make the oil business unviable and unprofitable. In an effort to exemplify the unviability of the formula by one of the oil marketers, they have observed that, "the formula does not reflect the operational conditions as they currently are. In their view its costs them Kshs.15/= to transport one litre per kilometer using the big haulage companies yet the formula has pegged that costs at KShs.7.50/=". It is not clear how this figure was arrived at.

¹⁰¹ Total Kenya- Managing Director observations during the reading of the end of year financial statements for the company 2011

¹⁰² Total Kenya financial statements for the company for the year ending 2011

¹⁰³ Marketers are concerned that the formula for setting price caps does not cater all operating costs, infrastructure costs and the negative effects of system ineffectiveness such as that refining.

¹⁰⁴ Bimal K. Mukherjee, Chief Executive Officer Kenya Petroleum Refineries Limited – in correspondence to the Director General Energy Regulatory Commission and copied to petroleum institute of Kenya in July 2011.

¹⁰⁵ Ibid note 94

The price controls are also perceived as threat to the small firms (independent dealers) and will stifle growth for some of these firms. The margins are seen to be too low for these companies to break even and as a consequence the small firms are unable to invest in long term projects like petrol stations and depots¹⁰⁶. These observations are a clear indication that the regulations are not only a threat to the big firms and multinationals but also to the indigenous ones.

According to Oil Libya Kenya's managing director, while writing to the Energy Regulatory Commission he complains that the Petroleum Pricing Regulation 2010 formula does not recognize nor provide for investment in storage depots¹⁰⁷. It is quite clear that companies that have invested in these facilities spend colossal amounts of money to maintain these facilities, yet the formula does not take cognizance of this fact and yet such maintenance costs are part of the operational costs for these companies.

It follows therefore that for the reason that the formula does not seem to acknowledge this operational costs, the businesses shall obviously become unprofitable for those companies that have invested in these facilities and yet the same facilities are extremely important in the operations of these companies.

Oil Libya's firm position is that the basis of the wholesale and retail margins are unknown. In their view the application of what they believe are arbitrary margins are not ideal for the industry.¹⁰⁸ Oil Libya, Kenya Shell, Kenol Kobil and Total Kenya, with a more than 75% stronghold on the Kenyan fuel market, have given indications that controlling the fuel prices as currently being applied by the Energy (Petroleum Pricing) Regulations 2010 will eventually see the exit of multinational firms.

¹⁰⁶ Peter Njeru, a member of Petroleum Association Of Kenya while giving his views about the Energy (petroleum pricing)regulations 2010 on 7th june 2011 at a workshop organized by the Energy Regulatory Commission.

¹⁰⁷ See note 107

¹⁰⁸ Rida Elamir-Managing Director-Oilibya, Complaint letter to the Energy Regulatory Commission-2011, relating to the Energy (petroleum pricing) regulations 2010.

The Investors here all seem to cite that the instant regulations negatively affect their businesses.¹⁰⁹ The observations are accurate as already major multinational companies that were operating within the petroleum sub-sector have already exited the Kenyan market and this has to some extent been attributed to the pricing formula generated by the Energy (Petroleum Pricing) Regulations 2010. The earlier observation that the regulations appear to shave off margins by the oil companies is likely to hold as businesses would rarely want to operate in an environment that exposes them to the risk of incurring losses as observed herein.

3.2 Fuel Shortages

Since the inception of the Energy (Petroleum Pricing) Regulations 2010, on numerous occasions, there are frequent reported cases of acute shortage of fuel within Kenya. Very often, with the announcement of fuel prices by the Energy Regulatory Commission, (usually the 15th day of the month) oil marketers appear reluctant to sell fuel stocks in their possession especially when the prices seem reduced. Ordinarily this would happen as a result of instances where an oil marketer may still be holding on to previous stocks that had been acquired at higher prices. The obvious business decision by some of these companies would be to hold the said stocks if it is envisaged that there is a likelihood that the prices of fuel to be announced by the ERC is likely to be higher than prices in place prior to the announcement. More often than not this is done as means of trying to fetch prices that are higher to enable them recover their costs and margins.¹¹⁰ However other times, the same is done as a demonstration of the “greedy tendency” by some of the dealers.

¹⁰⁹ see note 92

¹¹⁰ Daily nation, August 2012 “Companies Blame ERCs for Fuel Shortage”

In other instances, the oil marketers, in anticipation of higher prices, may engage in malpractices such as hoarding of the fuel commodity so that when the ERC announces the prices that would be applicable for a certain period it is only at that time they would release the commodity to make super profits. In the situation described here, the shortages would usually be experienced in the period immediately preceding the 15th day of the month.¹¹¹

In a recent development, fuel shortage was reported around Kenya and oil marketers seemed very reluctant to sell at prices announced by the ERC. The commission had cut fuel prices by a significant margin of about KShs.7/= a litre. The announcement was meant to take effect two days later and most fuel companies had not bought the petroleum products as they had anticipated lower prices that had been presumably forecasted by the ERC. According to media reports¹¹², the shortages could have been worse if motorists had not stayed away from petrol stations on the days preceding the price announcement. In this particular instance, ERC had dictated a maximum price of KShs.111.91 for Super petrol, KShs.107.9 for Diesel and KShs.84.31 for a litre of Kerosene.

The shortages are usually characterized by long queues of motorists seen around petrol stations in Nairobi and all major towns as motorist scramble for fuel at the few outlets that maybe retailing the product. In the case already highlighted herein, Kenol Kobil, one of the biggest fuel companies blamed the shortage on the recent decision by the Energy Regulatory Commission to forecast a week ahead what they thought the prices for a particular month will be. According to their General Manager¹¹³ he sums it up by stating “it is the stupidity of ERC to predict prices, nobody wants to get stuck with expensive product and the wars created by ERC”.

¹¹¹ Ibid note 92

¹¹² Ibid note 92

¹¹³ David Ohana

Addressing the same issue, Petroleum Institute of East Africa¹¹⁴, warned that the Energy Regulatory Commission forecasts may lead to the retailers hoarding when prices are predicted to increase, or offloading expensive stock when prices are expected to decrease. In view of the practices discussed here, it may be accurate to observe that the new regulations by the ERC, seem to increase the suffering of majority of consumers.¹¹⁵ The conclusion here is made given the fact that the application of the said regulations seem to inform the conduct the oil marketers to hoard the commodity.

The observation here on the shortages of fuel do not rule out the fact that in the past delays in the supply of fuel at Changamwe oil refinery and Kenya Pipeline Company did also contribute to the shortages that would be experienced in the market. However it is necessary to indicate that the regulation did contribute to the shortages and especially at the time when they immediately came into force.

From the foregoing, it is not farfetched to observe that the introduction of the new regulations is attributable to this malpractice of hoarding fuel which has a consequence of creating shortages. The unpredictability and the lack of clarity in anticipated prices of petroleum products in the market are pushing most marketers to speculate on possible prices. In the course of their speculation most businessmen resort to hoarding the commodity in anticipation of increasing their margins way above those set by the regulations. Note must be taken here that with the application of the regulations now for about three years, shortages occasioned by the regulations are now on the decline.

3.3 Increased Cost of Motor Fuel and Kerosene in Poorer Markets

Another unwanted result of the capping move is that petroleum product pricing in poorer rural markets now cost more. The reverse was the case before price capping

¹¹⁴ Petroleum institute of Kenya is a body that promotes the interest of the Petroleum Industry in Kenya. Reference views published on the organization website www.petroleuminstitutekenya.com accessed 16th July 2012

¹¹⁵ Ibid note 92

law. The Energy (Petroleum Pricing) Regulations 2010 formula cumulatively adds transport costs from the urban depots of the oil marketers.¹¹⁶ The further away the market is away from key depots, the higher the prices and the converse is true. Previously, the marketers would simply total their costs and take care of such market realities by segmenting their market.¹¹⁷ Premised on the fact that most rural towns lack fuel depots and rely on the depots located in urban areas, the increased cost of transportation of fuel to these towns has the net effect of escalating fuel prices as envisaged by the formula enacted.

Another observation is that, with the regulations in force, even in urban areas like Nairobi, fuel prices are the same at all stations. Prior to the enactment of the Energy (petroleum pricing) regulations 2010, fuel was ordinarily more expensive in higher income areas. By conducting business in this way oil marketers were able to recover the margin lost in lower pricing in lower income market segments.

The introduction of the fuel regulations has obviously occasioned suffering to the poor sections of the population particularly those in rural areas as well as low income areas of urban centers.

Kerosene which is considered the poor man's energy has also become expensive due to the Energy Regulatory Commission's regulations that seem not to bear in mind market realities that the fuel is used by the low income groups. Previously, oil marketers priced kerosene at very thin margins. They leveraged that on their overall strategy to benefit from diesel's high sale volumes and petrol's flexible margin pricing. Infact the main focus on kerosene was increasing market share around high sales.¹¹⁸

So whereas the sharp price increases are no longer witnessed in the subsector as was the case in the past, allowing for some stability, the price caps regulations has significantly ended up hurting the economically vulnerable whom it meant to protect if at all.

¹¹⁶ Regulation 4(a) and (b) and the first schedule to the petroleum pricing regulations

¹¹⁷ Eugene Obiero, "Is Regulation of Fuel Price Good for Kenya?" Daily Nation 23rd August 2011.

¹¹⁸ Ibid note 116

On the other hand, proponents for the regulations seem to be of the view that the Energy (petroleum pricing) regulations 2010 are necessary in the overall performance of the economy and they seem to advance some of the following reasons discussed hereunder as the benefits of a controlled fueled Subsector.

3.4 Guaranteed Margins

According to the Ministry of Energy under the price controls regime currently in place in the fuel subsector profit margins are guaranteed to the dealers across the board¹¹⁹. Previously, there was a view that before the era of controls, money was being made in Nairobi and very little beyond Naivasha and western Kenya¹²⁰.

The view stems from the assumption that based on the fact that the prices are projected to be inclusive of the transport costs to the destinations where the product will be retailed, the dealers in those far flung areas are guaranteed of their margins as the price is inclusive of the actual costs of transporting the produce to that destination as captured by the formula. Where prices are not controlled and margins not regulated, some dealers may use predatory practices in business to deliver their products to their respective markets with the net result of locking out other players from the business.

The demand by the regulations under discussion to affix a definite margin on both the wholesale product and that for the retail has ensured that the majority of small businesses continue to remain in business. In the absence of such rules, there is the real likelihood that some dealers can use predatory practices which may push other players out of business.

¹¹⁹ Mahmoud Mohammed, Kenya's Assistant Minister for Energy comments in article published by the Business Daily Africa in June 2011

¹²⁰ According to Mwendia Nyaga a petroleum consultant at the ministry of energy in an interview conducted by the Business Daily Africa in June 2011

Since the introduction of the regulations it has been observed that there are an increased number of small dealers who are entering into the retailing business of petroleum products. There has been notable mushrooming of “filling stations” as they are popularly known in many rural markets, small feeder roads and the estates as opposed to the high end oil dealers’ stations motorists are used to on the main highways¹²¹.

Guaranteed margins provided for under the regulations seem to be the push that most of these small dealers are relying on to remain afloat in business. Previously when the current regulations were absent, the petroleum business was largely perceived as a preserve for the large multinational companies. The small dealers would not venture in certain market segments that some of the large petroleum companies had earmarked for themselves and any attempts to do so would be met by offers from these large companies to consumers that would make people shy away from the small dealers. For instance Total and Mobil had offers for free car service with every purchase of oil products from them which offer would easily make motorists to shy away from small dealers who would not be able to offer such car service for free as they do not enjoy the economies of scale to offer such services for free¹²². In my view, I consider the practice here predatory as it is clearly intended to entice the consuming public in a way that will eventually push the small dealer out of business for being unable provide a similar service yet at the same sell the fuel at the same price as the large corporation.

3.5 Exploitation of Consumers is Reduced

Contrary to popular belief that in a free market, consumers usually obtain the best prices for commodities, the situation with the Kenyan petroleum industry is observed differently.

¹²¹ Eugene Obiero, “Is Regulation of Fuel Price Good for Kenya?” Daily Nation 23rd August 2011.

¹²² Ibid note 121

The petroleum market in Kenya has been dominated by a few multinationals¹²³. These companies are often perceived as cartels due to their perceived mode of operation. In the period prior to the controls, observers say, majority of these companies would collude and fix price of fuel products at levels that were completely outside the market fundamentals¹²⁴.

Infact it was common practice that on occasions when the world oil prices were low some of these companies would continue to retail the products at the higher prices and in the process make super profits while defying the falling prices of crude oil at the world market¹²⁵. Prices these companies would fix were not the actual prices of the products and in turn the consumers ended up being exploited for paying unconscionable prices. On the basis of such conduct by the said companies, the public for these reasons perceives them as cartels¹²⁶.

With the coming into force of the Energy regulations on petroleum pricing, this behavior by the oil companies to fix their cartel prices has to a larger extent been put to check as the regulations criminalises the sale of fuel products above those gazette by the Energy regulations¹²⁷. However the oil marketers in an effort to seek alternative avenues to generate high incomes are currently seeking to increase their margins in business segments not directly impacted by the price formula. These segments include cooking gas, jet fuel, lubricants, marine sales and services at retail fuel stations.

In the absence of the Energy regulations under discussion, rising food and energy costs were causing protests around the country. There was general economic turmoil in the country and this was characterized by frequent demonstrations around parliament buildings seeking government intervention on the rising cost of living. The government

¹²³ Business Daily, Nation newspapers, 'ERC formula for fuel prices raises queries', Mungai Kihanya, 4th march 2010

¹²⁴ Ibid note 119

¹²⁵ Ibid note 119

¹²⁶ Petroleum insight, 'Oil and Gas: The challenge of protectionism in Kenya', Caroline Njoroge- Company secretary Kenya Petroleum Refineries Limited.

¹²⁷ Regulation 4 on petroleum pricing it imposes a fine of Kenya shillings one million for those contravening the regulations.

had to buckle under the weight of this pressure arising from the protests in December 2010 when the Energy Regulations on Petroleum Pricing 2010 came to effect. The increased cost of living was becoming unbearable to the majority of Kenyans who have low incomes and by controlling the fuel prices, the government was being seen as doing its prime duty of protecting citizens from exploitation by the oil marketers.

3.6 Price Caps Have Increased Efforts to Explore Oil

Premised on the fact that Kenya does not domestically produce the oil commodity and that the base price of the product is determined abroad (net of taxes and other elements such as transport, margins among others), It is becoming increasingly necessary for the Government of Kenya to engage in efforts to search for local oil deposits and ease the suffering of its citizens by the burden of predetermined import prices. In the recent past it has been observed that the government has increased exploration activities on various oil blocks around the country, with the hope that where deposits of commercial value are found, Kenyans may enjoy the benefits of cheap fuel¹²⁸. Currently a number of companies have been given exploration contracts in Kenya in the Turkana Region and off the coast of Lamu¹²⁹ in the hope that these efforts will bear fruit, Kenyan citizens are likely to benefit immensely from locally produced fuel.

From the foregoing discussions, it is quite evident that the introduction of the Energy (Petroleum Pricing) Regulations 2010 has had a huge impact on the economy at large. The study here has observed that even despite the law being in place, the prices of fuel products have not come down any significantly. The continued over reliance on imported crude oil into the country from which fuel products are extracted from, appears to have eroded the gains that may have been intended from the said

¹²⁸ Kenya government has engaged Tullow Oil limited, a Canadian firm in the exploration of oil deposits. As at October 2012, the company was reported to have struck crude oil deposits at its second well named Twiga well 1. The first well was drilled at a location known as Ngamia 1 and the deposits found there were said to be of commercial value. Both wells are located in Turkana County.

¹²⁹ Tullow Oil limited and Africa Oil limited

regulations. Bearing in mind also the fact that, ERC has no control over quite a sizeable number of factors that determine the price of fuel products.

In my view, the said regulations are handicapped in addressing the problem of ever rising fuel prices. Instead the legislation has occasioned the increase of a host of negative practices by a number of marketers such as hoarding and fixing of prices in the business segments not affected by the legislation. Such practices obviously just worsen the suffering of Kenyans whose cost living continues too high.

In conclusion the following observations can be made about the Energy (petroleum pricing regulations) 2010. By and large, the said regulations have to some extent fallen off the mark and purpose for which they were intended to achieve. In my view and from the findings in this work, the negatives seem to surpass the positives and yet the legislation continues to be very pertinent in determining the fate of businessmen and consumers within the oil subsector.

Petroleum subsector remains a very pivotal in attaining serious economic gains in Kenya and therefore sufficient effort should be made to ensure that the subsector remains vibrant. The need to create vibrancy in the subsector is in line with the government aim to improve the general well being of its citizens, increase and/or create wealth as well create a good environment to encourage investment. Effort must be made therefore to correct the shortcomings that have come along with this very important piece of legislation so that the said law brings growth in industry as well as satisfaction to all stakeholders.

Taking a leaf from best practices in other jurisdictions that have similar laws on price capping may be necessary so as to improve on these regulations that govern the price of this vital commodity in Kenya. The next chapter shall deal with lessons that Kenya can borrow from other jurisdictions in so far as fuel pricing is concerned and avenues that can be adopted in our scenario to make fuel/energy subsector flourish so as to meet the goals set for the achievement of Vision 2030.

CHAPTER 4

4.0 REGULATION OF FUEL PRICE IN OTHER JURISDICTIONS

Having analysed in the preceding chapters the manner in which the Energy (petroleum pricing) regulations 2010 are applied in arriving at the capped fuel prices as well as the gaps apparent on the face of the said regulations; this chapter shall address how fuel prices are regulated in South Africa being a country that provides some of the best practices in fuel price regulation. Further there will be an overview of the law enacted in South Africa to regulate fuel price, other non-legal strategies used to manage the oil industry and lessons that Kenya can learn in the management of the oil subsector. The focus of this chapter will be confined to South Africa.

4.1 Case study for South Africa

Just as the case is in Kenya, in South Africa, the prices of petrol are regulated by the government and pump prices changes every month on the first Wednesday of the month.¹³⁰

The prices of petrol just like in other markets are influenced by the supply and demand for crude oil, exchange rates and local government taxes. The need to regulate the prices of fuel in South Africa arose from the frequent fluctuations and increase in the prices of fuel. Internationally as South Africa remains a net importer of crude oil the fluctuations in the prices of fuel can be explained by a number of reasons.¹³¹

Fluctuations in the prices of fuel in South Africa, just as in the case of Kenya has been occasioned by the recent uprisings in countries such as Libya, Egypt, Bahrain, Syria among others which are very large producers of crude oil. There was fear that the uprisings in these countries would spill over to Saudi Arabia, the world largest oil producer. The instability in that region affects oil production as it occasions the

¹³⁰ Source- Central Energy Fund Act No 38 of 1977 previous Act referred to as South Africa's State Oil Fund Act

¹³¹A South African Petroleum Industry Association publication on the web. Relevant link- www.sapia.co.za

shutting down of oil plants and hampers transportation of fuel essentially decreasing the supply of oil thus causing the price fluctuations.¹³²

Fuel price increase in South Africa, has also been occasioned by the weakening of the Rand (the official South African currency). As a net importer of fuel, South Africa trades in dollars in the international market. When the Rand depreciates, the government of South Africa spends more money to buy the same barrel of oil that it may have previously purchased at a lesser price when the Rand was stronger as against the Dollar. In the absence of any intervention the weakening of the Rand will obviously make oil more expensive for South Africa and the price fluctuations will subsist.¹³³

Another reason for the increase in fuel prices in South Africa is the general volatility of crude oil prices at the world market. On numerous occasions, it is observed that crude oil prices among the oil rich producing nations suffers from frequent volatility which has results of escalating prices. Such distortions in the world market similarly have had the consequence of also increasing fuel prices in South Africa.

Premised on these reasons it became necessary to control the prices of the oil product in South Africa and the government is responsible for determining the fuel price. Through the control measures established by the South African Government, fuel prices in South Africa to a large extent do not fluctuate every time there is a change in price of crude oil internationally as the legislative measures in place ensure that the stability is in place.

The legislation that provides for the capping of fuel prices in South Africa is referred to as **Central Energy Fund Act No. 38 of 1977**¹³⁴ and it provides a formula on the components the basis of which fuel prices are calculated. Under the said legislation, the

¹³² ESMAP. 2010. "The Impact of higher Oil prices on low income countries and on the poor." Report 299/15 Washington DC. World Bank.

¹³³ Ibid note 128

¹³⁴ An Act to provide for the payment of certain monies into the Central Energy Fund and the utilization and investment thereof; for the imposition of levy on fuel and the utilization and investment thereof

price of fuel is determined by a number of elements that the legislation takes into account.

Petrol Pump Prices in South Africa under Central Energy Fund Act No. 38 of 1977 are composed of a number of price elements and these are divided into international and domestic elements under the said legislation.

4.2 Under the international elements,

Basic Fuel Price (BFP), is based on what it would cost a South African importer to buy fuel from an international refinery and transport the product into South African shores. The BFP formula reflects the realistic cost of importing a litre of product from international refineries with products of a similar quality compared to local South Africa specifications on a sustainable basis.¹³⁵

The BFP formula changes on the first Wednesday of every month based on the average daily international price moments and exchange rate fluctuations based on a “3 working day Optimisation” mechanism.¹³⁶ In other words the number of days between the first Wednesday of each month when fuel prices are adjusted and the last working day to which fuel data is collected to determine price changes, will be restricted to 3 working days prior to the price change.

Below are components of BFP formula as highlighted verbatim from a publication of the South Africa’s Central Energy Fund and include¹³⁷:-

International Petroleum Market Spot Prices- The largest component of the basic fuel price is the price that it would be paying in international markets when physically importing product to South Africa. The FOB (Free on Ship’s Board) product prices from different locations in the world, based on international product availability and product

¹³⁵ South Africa’s Petroleum Industry Association –Industry Overview Publication in February 2012 on the web pages- www.sapia.co.za

¹³⁶ Ibid note 132

¹³⁷ Energy updates on line news- a South Africa’s Central Energy Fund (CEF) publication on behalf of the Department of Minerals and Energy, website www.cef.org.za/ accessed on 19th November 2012

quality are used. The Petrol FOB price is calculated at 50% of the Mediterranean spot price for premium unleaded petrol and 50% of the Singapore spot price for 95 Octane unleaded petrol. Different locations prices used in the determination of this component enable the South African Authorities to arrive at a fairly balanced priced as opposed to applying a price emanating from only one source.

Freight cost to bring product to South African Ports is also another component of the BFP and reflects the cost of voyages from Augusta (in the Mediterranean), Singapore and Arab Gulf. Tariffs as published by the World Scale Associations for transporting refined products via medium range vessels to a weighted average to South African Coastal Posts, plus demurrage for an average vessel for 3 days¹³⁸. In applying the freight cost of the voyages to bring the product to South Africa, the rate applied is the average from the different sources aforementioned and which is a good thing as it provides a fairly balanced cost.

Insurance Costs and Ocean Loss Allowance -This covers insurance costs as well as other costs such as Letters of Credit, and agent fees. In international petroleum products trading, shipping and insurance, a loss of 0.3% for products has been accepted as normal leakage and loss resulting from evaporation. Standard insurance practice finds it exceedingly difficult to cover such incidentals. Simply put, such losses are not insurable and have to be accepted by the buyer and are referred to as Ocean Loss Allowance¹³⁹.

Cargo Dues and Coastal Storage charges¹⁴⁰ are also necessary price components of the BFP. According to the South African Act, calculates cargo dues changes in terms of Ruling National Ports Authority of South Africa contract tariffs for petroleum products. Primarily the costs here relate to the handling charges incurred on the petroleum

¹³⁸ *ibid* note 134

¹³⁹ *ibid* note 134

¹⁴⁰ Stock financing cost is based on the landed cost of refined petroleum products, 25 days of stockholding and interest at 2%. Source- <http://www.energy.gov.za/files/esources/petroleum/petroleum> accessed On 19th November 2012

products at all national ports. In addition to the aforementioned the coastal storage charges are also comprised as part of the BFP and these are costs realistically incurred in a substantial import scenario, related to costs of the handling facilities at coastal terminals providing storage¹⁴¹.

Stock Financing Cost¹⁴²- the BFP includes a charge for the financing of coastal stock of an importer, at an interest rate of 2 percentage points below the ruling prime rate of the Standard Bank of South Africa. The BFP as determined above is converted to SA cents per litre by applying the applicable SA Rand/US Dollar exchange rate, and a constant litre per gallon factor for petrol.

4.3 Under Domestic Elements¹⁴³

To arrive at the final pump price in the different pricing zones (magisterial district zones) certain domestic transport costs, government imposed taxes and levies and retail and wholesale margins needs to be added to the international price.

Transport costs¹⁴⁴ this element in the fuel pricing component recovers the cost of transporting petroleum products from the nearest coastal harbour (Durban, Port Elizabeth, East London, Mossel Bay or Cape Town) to the inland depot serving the area or zone. Transport to the different pricing zones is determined by using the most economical mode of transport i.e. pipelines, road or rail. Apparently it is the only element which values differ per pricing zone, and is the reason why the petrol price is not the same for the whole country.

Delivery cost¹⁴⁵ as a component of the BFP is entirely aimed to compensate marketers for actual depot related costs (storage and handling) and distribution costs from the

¹⁴¹ Ibid note 137

¹⁴² Ibid note 137

¹⁴³ Ibid note 134 all in verbatim

¹⁴⁴ Ibid note 134

¹⁴⁵ Ibid note 134

depot to the end user at service stations. The value is calculated on actual historical costs of the previous year, averaged over the country and industry.

Wholesale (Marketing) margin¹⁴⁶ also forms a component of the BFP and it is a margin calculated on an industry basis and is aimed at granting marketers a 15% margin on depreciated book values of assets and with an allowance for additional depreciation, but before taxation and payment of interest.

Money paid to the oil company through whose branded pump the product is sold, to compensate for marketing activities. The margin is controlled by the government, allowing for changes based on the oil companies' return on their marketing assets. The formula used to determine the wholesale margin is based on the results of a cost/financial investigation by a chartered accountant firm into the profitability of the wholesale marketers.

Importantly here is the fact that the margin affixed by the government, is not static and there is adequate latitude under the South Africa's Central energy fund Act, to allow for the adjustment of this margin based on the oil companies' return on their marketing assets. Further the margin is not arrived at arbitrarily but through a financial investigation by an independent accounting firm on all costs variables that go into the question of establishing the profitability of the wholesale marketers.

The Retail Margin¹⁴⁷ also forms part of the BFP and is fixed by Department of Minerals and Energy (DME) and is determined on the basis of actual costs incurred by the service station operator in distributing petrol. Account is taken of all proportionate driveway related costs such as rental, interest, labour, overheads and profit. The way in which the margin is determined creates an incentive to dealers to strive towards greater efficiency, to beat the average and to realise a net profit proportionate to their efficiency. Further it is apparent that the retail margin in South Africa takes into account actual related costs

¹⁴⁶ See note 134

¹⁴⁷ Ibid note 132

incurred at a retail dispensing dealer and hence most of the operators have a sense of satisfaction on the margin affixed by the statute.

Equalisation Fund levy¹⁴⁸ is statutory fixed monetary levy fund, and is regulated by ministerial directives issued by the Minister of Mineral and Energy Affairs in concurrence with the Minister of Finance, as laid down by the Central Energy Fund Act, No 38 of 1977 as amended in terms of ministerial directives. The fund is principally utilised to smooth out fluctuations in the price of liquid fuels through slate payments; to afford fuel producers tariff protection and to finance the crude oil "premium (price differential applicable to South Africa oil purchases during the late 1970's). The levy on the fund is a charge on the BFP.

Fuel tax¹⁴⁹, customs and exercise levy¹⁵⁰ under the BFP is comprised as the tax levied by Government annually and adjusted by the Minister of Finance effective from the price change in April of each year, announced during the annual budget speech. The price of fuel cannot overlook this component, as it is part of revenue collection on the part of the South African government. The customs and exercise levy arises from an existing customs union agreement and is imposed on all items that fall within the scope of the agreement.

Road Accident Fund (RAF) is a fund used to compensate third party victims in motor accidents in South Africa and part of the money invested in this fund are comprised in the BFP, the income to this fund is generated from petrol and diesel and just as the other previous levies discussed here, the same is determined by the minister. Equally there is a slate levy paid by the motorists so as to recover monies owed to oil companies due to time delay in the adjustment of the petrol pump price. It follows therefore that the

¹⁴⁸ The equalization fund levy is normally a monetary levy that is used to equalize fuel prices. The rates applicable are determined by the minister for minerals and energy. Source-

<http://www.energy.gov.za/files/esources/petroleum/petroleum> accessed On 19th November 2012

¹⁴⁹ The levy is only applicable on diesel and petrol and is determined by the minister for minerals and energy

¹⁵⁰ See note 145 same reference

components highlighted here essentially form the basis for which fuel price arrived at in South Africa. The discussion that follows hereunder is a comparison between the regulation carried in Kenya and that in South Africa.

4.4 Comparisons between the mechanisms of regulation within the oil industry in Kenya with that of South Africa.

Comparing the components of the Basic Fuel Price highlighted here and those that the Energy (petroleum pricing) 2010 captures in its formula, it is evident that to a large extent that both the legal position obtaining in Kenya and that in South Africa takes into consideration quite a number of factors in determining the applicable price of the fuel products and which factors have been highlighted in the earlier parts of this work.

Under the South African law formula to a large extent the same is as a result of negotiations between the government of South Africa and oil Industry players such as The African Mineral and Energy Forum (AMEF)¹⁵¹ which is a trust promoting positive development and empowerment in the energy industry in South Africa through seeking and allocating funds for programmes and projects in energy and South African Petroleum Industry Association (SAPIA)¹⁵², which essentially agreed on the pricing formula mandating import parity in the price structure¹⁵³.

The parity in the formula is achieved as a result of obtaining an average daily international price movements and exchange rate fluctuations based on a "3 working

¹⁵¹ http://www.ameforum.co.za/about_africa_mineral_and_energy_forum.asp accessed on 19th November 2012

¹⁵² SAPIA represents the collective interests of the South African petroleum industry. The Association plays a strategic role in addressing a range of common issues relating to the refining, distribution and marketing of petroleum products, as well as promoting the industry's environmental and socio-economic progress. SAPIA fulfils this role by contributing to the development of regulation in certain areas of South African policy; proactively engaging with key stakeholders; sharing research information; providing expert advice; and communicating the industry's views to government, members of the public and media.

¹⁵³ Source; South Africa Petroleum Industry Association online publication. www.sapia.co.za/industry-overview/fuel-price.html- accessed on 19th November 2012

day optimization” mechanism. In other words between the first Wednesday of each month when fuel prices are adjusted and the last working day in which fuel data is collected to determine price changes, will be restricted to 3 working days prior to the price change¹⁵⁴.

Mechanisms by the formula ensures that the figure arrived at is fairly balanced for the period in which the price is going to be applicable. Essentially the price covers a fairly extended period on both the price of fuel internationally and also the exchange rate movements of the Dollar against the Rand. In my view this approach gives a more balanced picture on the price that is more reflective of the actual prevailing rates on the market¹⁵⁵. The approach proposed by the Energy (petroleum pricing) regulations 2010 is arrived at by considering the dollar rate on the date preceding the price change and this may not be fair as the average the Dollar exchange rate against the Shilling over an extended period say 3days or more is more likely to give an accurate price as opposed to the one day currently envisaged by the regulations.

In so far as the freight costs are concerned, the formula equally reflects the costs of voyages from several destinations renown for exporting refined products. Presently destinations against which this component is pegged against are Augusta (in the Mediterranean Region), Singapore and the Arab Gulf¹⁵⁶. The varied options here from where to source the refined product clearly increase the latitude of availing the fuel products at the most competitive prices as opposed to single sourcing that occurs with the open Tender System applied by the Energy Petroleum (Pricing) Regulations 2010 applicable in Kenya, which largely relies on the Arab Gulf’s fuel prices¹⁵⁷.

¹⁵⁴ Source- <http://www.energy.gov.za/files/esources/petroleum/petroleum> accessed On 19th November 2012

¹⁵⁵ Ibid note 151

¹⁵⁶ Source: Energy updates on line news- a South Africa’s Central Energy Fund (CEF) publication on behalf of the Department of Minerals and Energy November 2012.

¹⁵⁷ Refer to chapter 2 of this report.

On the premise that the basic fuel price, seeks to get the realistic price of what it would cost a South African importer to buy petrol from an international refinery and to transport it to South African shores, the refineries in South Africa are compelled to be very competitive so as to be favourably considered as against the very efficient refineries overseas.

The formula exposes South African Refineries to the serious threat of overseas competition as the Basic fuel price is determined from an average of the prices of the fuel commodity from the most efficient refineries in the world; consequently majority of the refineries in South Africa have been compelled to become equally efficient and hence making the product fairly cheap.

In the Kenyan case, oil marketers have made numerous complaints that the formula provided by the Energy Regulatory Commission, also factors losses attributed to the inefficiencies of Kenya Petroleum Refineries Limited. The inclusion of such losses is an additional and unnecessary cost to the consumer and in my view it may be necessary that the Energy Petroleum (Pricing) Regulations 2010 should be adjusted to consider exposing the refinery at Mombasa to external competition and allow it to reorganize itself to operate on a strictly commercial basis like the refineries in South Africa. Alternatively if it appears that operating the state run refinery will continually be occasioned by losses, then it may be necessary to have it competitively privatized or Kenya should explore the possibility of importing ready refined products from the very efficient refineries around the world.

In so far as the wholesale and retail margins applicable to the South African formula, the same are obtained in a very clear and transparent manner. In the South African case, the whole margin is based on the result of a cost/financial investigation by a chartered accountant firm into the profitability of the wholesale markets. The level of the margin

is aimed at granting markets 15% return on depreciated book values of assets, with allowance for additional depreciation, but before tax and payment of interest.

The approach used here by South African Authorities appears acceptable to most oil marketers as this approach takes into account the cost of putting up assets/infrastructure such as depots and oil terminals necessary for the oil distribution business. In Kenya, majority of the oil marketers are of the view that the origin of the margin is unknown and that most oil companies reckon the fact that the formula does not take into account what it costs to put up the infrastructure that supports their business. In their view, the fuel formula fails to take into account their operating costs.

Regarding the issue of retail margins, under the South African scenario the retail margin is fixed by the government and is determined on the basis of actual costs incurred by a service station operator in distributing petrol. Factors such as rent, interest, labour, overheads and profit are taken into consideration. When this is done, it ensures overall profitability by the retail dealers. Under the Energy (petroleum pricing) Regulations 2010, it is not very clear how the margin is arrived at and who exactly does the ascertainment but the regulations have affixed the margin. The obscurity in the manner in which this margin is arrived at is a major shortcoming to the Kenyan law on fuel price capping and certainly poses as a major impediment to the growth of this business.

To ease the burden of most consumers, the South African scenario provides for an equalisation fund, where this fund under the directions of the Minister for minerals and energy affairs in consultation with the Minister for Finance, run a government fund which is principally utilized to smooth out price fluctuations in the price of liquid fuels within South Africa. By so doing, the consumers generally enjoy stable prices for the commodity even when world international prices are fluctuating. Such a strategy is absent in the Kenyan case. In my view, Kenya can copy some of these strategies in its

regulations from the South African scenario discussed to better the regime governing fuel price regulation.

Regulation of fuel prices in the South Africa by way of legislation is a strategy employed there specifically as a means of protecting both the oil marketers and the consumers. In the South Africa the law on fuel price regulation is intended to limit the consuming public from the exposure of the volatile international prices of crude and other petroleum related products. The law also at the same time prohibits oil dealers from charging prices above those set by the Central Energy Fund Act while providing for accurate returns and profitability of the businesses.

Kenya's Energy (petroleum pricing) regulations 2010 were equally enacted for the same reasons but however the variables affecting the cost of fuel under the Kenyan regulations to some extent are unclear and thus raising numerous concerns regarding the effectiveness of the formula to set actual prices for the fuel products. The concerns in issue cast lots of doubt whether the consuming public and the dealers are protected by this law.

Under the Kenyan regulations prices affixed by the ERC are largely aimed to ensure that the consumers do not purchase the fuel products beyond a certain maximum. Dealers are at the same time prohibited from going against the provisions of the law while there is also an effort to regulate the returns attainable to the dealers. In my view, the law makes the market less competitive considering the numerous complaints raised concerning the pricing policy that it fails to reflect actual costs of the fuel product.

The experience in Kenya is that with the introduction of the Energy (Petroleum Pricing) Regulations 2010, the major oil companies are of the view that the regulations if not reviewed may eventually push most of them out of the market. Majority of these companies it has been shown in the previous chapter are of the preposition that applying the regulations among other reasons makes them unable to meet their

operating costs and hence they are likely to have no choice but to quit the petroleum market in Kenya.

While the Kenyan legislative situation appears keener to regulate the dealers from employing unfriendly market conduct with a view of ensuring that the consumers do not pay beyond a certain price on fuel products. South Africa's' experience is focused at both stimulating growth of business by protecting oil dealers businesses and protecting consumers by curtailing the possibility of unfriendly market conduct by limiting fuel price threshold.

Recently in Kenya, the Competition Act¹⁵⁸ that is yet to be fully operational was given ministerial effect so as to start applying. The act came into force close to a year after the Energy (petroleum pricing) regulations 2010 were already in force and as such the country is yet to realize the benefits that the said act has to offer. Importantly the act seeks to promote and safe guard competition as well as protect consumers from unfair and misleading market conduct¹⁵⁹.

Currently, the challenges facing the implementation of the Competition Act is that country is yet to set up the competition tribunal that was intended to determine market conduct related disputes arising from businesses. However full implementation of this act would lend the energy regulations under discussion in this work the necessary legislative support to curb unfriendly market practices relating to pricing as the Competition Act is more elaborate on offensive business conduct which the Energy regulations here try to address particularly on the aspect of fuel pricing.

In summary, the discussions here highlight the fact that even in the most advanced economies; states are unwilling to completely rely purely on market forces to determine the prices of fuel products and government intervention in trade is still evident. The

¹⁵⁸ Act no 12 of 2010

¹⁵⁹ Preamble to the Competition act

drive for the enactment of legislation to regulate fuel pricing is mainly with the aim of protecting both the consumers and to some extent the dealers.

Experiences from South Africa are a clear and persuasive that there is room to better our situation. Kenya can as well borrow from both the South Africa experience in the manner in which the law on fuel capping can be applied. Despite the distinct comparative situations between Kenya and South Africa, it is my view that this jurisdictions does offer options that may as well address some of the concerns that various stake holders in the fuel subsector in Kenya have raised. The next chapter shall in conclusion of this work highlight the recommendations that Kenya may adopt as means of improving the efficacy of the Energy (petroleum pricing) regulations 2010.

CHAPTER 5

5.0 RECOMMENDATIONS & CONCLUSION

The coming into force of the Energy (Petroleum Pricing) Regulations 2010 has brought into focus the degree of discontent in this piece of legislation amongst the various stakeholders within the oil subsector. Both the oil marketers and consumers have raised concerns that seem to imply that even though these regulations were well intended their coming into force has either adversely affected their business and or even increased the suffering of the consuming market. The impact of these regulations has been discussed in chapter three of this work.

Below are some recommendations which in my view if taken into consideration may as well ease the “suffering” of the parties concerned in this subsector as a consequence of the application of this regulating fuel prices in Kenya and foster overall growth in the Kenyan economy which is to a large extent influenced by the distortions within the energy sector.

5.1 Increasing the Efficiency of Kenya Petroleum Refineries Limited

The fuel pricing law, in its application takes into account the losses that are made by the refinery at Mombasa in the final price of fuel. In my view, losses incurred at the refinery are not part of the actual costs of processing fuel. By increasing the efficiency of the refinery, the Energy (Petroleum Pricing) Regulations 2010 will exclude or significantly reduce the component of refinery losses in its pricing formula and consequently make the product cheaper.

The government of Kenya should make an effort to invest in more advanced technology at the refinery for purposes of enhancing its efficiency. Currently the refinery in Kenya requires experiences a lot of operational disruption due to its age and it is proposed that procuring newer equipment will address these challenges. Doing so will to a large extent bring down the cost of fuel and reduce the numerous complaints relating to the

pricing of fuel, which has to factor losses accrued by the refinery in the costing of fuel. Once the efficiency of the refinery is addressed, it will be prudent to make amendments to the subject legislation so as to exclude refinery losses as part of the fuel pricing formula.

5.2 Inculcate Transparency while Determining the Wholesale and Retail Margins.

In the earlier parts of this work (chapter two and three), we established that majority of the oil companies in Kenya are of the firm view that the current wholesale and retail margins being applied by the Energy (Petroleum Pricing) Regulations 2010 are arbitrary and do not seem to appreciate the cost of investments that oil marketers have put in this business.

According to these companies there is no clarity in the manner in which the Energy Regulatory Commission carries out the margins incorporated in the regulations. In order to dispel the discontent among the oil marketers, borrowing from the South African experience (already examined in the previous chapter) may possibly assist in reducing these complaints that the marketers are raising. In the South African case, the Central Energy Fund determines the wholesale margin based on the results of a financial investigation by a chartered accountants firm into the profitability of the wholesale marketers. Kenya can equally adopt the same strategy so as to create the perception that the margin is arrived at in a fair manner. Further it may be necessary to have a more open and consultative platform through which most of the stakeholders within the petroleum subsector are involved in the formulation of such laws that are aimed at regulating the business.

Kenya can as well borrow from the American model such as the North Carolina Gasoline Market Act which legislation has the effect of protecting both the marketers and consumers. The American here model is premised on the reality that there could be oil marketers that may be out to use unconventional business practices such as predatory pricing; such players' activities are monitored by the federal state

government through this legislation which curtails any such attempts to cost the fuel below what would be the actual cost¹⁶⁰. Measures prescribed under this law guarantees the small oil marketers continue to thrive in the business without the fear that that a highly placed oil marketers will push them out of business. It is in light of such achievements that it can be said that these law protects the marketers.

On the other hand, consumers are also protected to the extent that there is no likelihood that a highly placed oil marketer as a consequence of contravening the law can drive out other small marketers (kill competition) to the extent that such a marketer becomes a monopoly. Common knowledge within the economic sphere dictates that there where a business is a monopoly, there is a tendency that it will inflate prices of commodities that it deals with. By this law undermining the possibility of monopolies emerging, consumers are equally protected from monopolistic prices. The law on fuel pricing in Kenya can be adjusted so as to fit into our circumstances but within the model of the anti sales below cost legislation such as that of North Carolina.

In my view pursuing such a strategy will certainly take into account the operating costs of most oil marketers and effectively cushion them with a margin that shall keep afloat their businesses.

5.3 Increased Exploration Activities

Premised on the reason that Kenya remains a net importer of oil, we largely have no control over the prices of fuel that the country purchases (especially crude oil) at the international market. The Free on Board Price of crude oil is pre-determined by the nations of oil producing companies together with other costs such as freight, insurance among others.

Producing our own oil will largely reduce the cost of fuel locally if such resources are adequately managed. The recent oil find in parts of Turkana County is very

¹⁶⁰ Refer to chapter four of this thesis the discussion relating to how the North Carolina Gasoline Market Act and how the legislation has been effectively used to regulate fuel price in the state on North Carolina in the USA.

encouraging even though a lot has to be done in terms of how those resources shall be managed besides also how the revenues shall be distributed with the oil prospecting companies. The exploration of oil deposits is largely expected to lower the price of fuel retailing in Kenya. Primarily our own institutions will be able to determine the cost of the fuel as opposed to the present situation where the same is determined by the nations producing oil.

5.4 Use of Efficient Fuel Transportation Methods to Rural Areas

The observation that the transport component under the Energy (Petroleum Pricing) Regulations 2010 has increased the cost of fuel in the rural areas primarily is fairly accurate. Reducing the cost of fuel transportation will largely rely on applying the most efficient transportation method on the component of transport in the formula.

In my view transportation by pipeline appears most efficient and reasonable to apply on the formula in the far flung destinations. There should be a deliberate effort by the Government to put in place such infrastructure as the pipeline in some of the far rural places coupled with the construction of depots that will keep sufficient supplies to reduce the problem of hoarding that is characterized by the creation of artificial shortages by the dealers. Consistent availability of fuel within the market ensures that prices remain stable.

Equally the Government should have a deliberate effort to subsidize fuel commodities such as kerosene which is the primary fuel for most rural population. In view of the fact that the income levels of persons in the rural areas are very low, subjecting kerosene to the strict application of the fuel formula occasions prejudice and economic suffering to these groups with low incomes.

5.5 Increase Competitiveness and Transparency in the Tendering Process

In order to ensure that both the marketers and consumers enjoy the prospects envisaged under the fuel pricing formula, it is necessary that the tendering process used by the

Ministry of Energy to source for crude should be made more transparent. The price quotations should be the average for fuel sourced from various ports just as way of ensuring that the best and most competitive prices are awarded. Infact this is the approach used in the model similar to that in South Arica, where the prices of crude is the average obtained from sea ports on the Mediterranean and the Gulf of Arabia. Applying this model ensures prices obtained of fuel remain relatively steady even when there are fluctuations at the international market.

Moreover the government of Kenya, through the Central Bank must make a deliberate effort to increase the foreign currency reserves and especially the dollar which is frequently used while trading at the international market. Having sufficient foreign exchange reserves, enables prices of the fuel commodity which is purchased using ¹⁶¹foreign to be fairly stable even when the value of the shilling fluctuates as against other foreign currencies. Knowing very well that the US dollar is the invoicing currency of international crude oil trading and variations in the exchange rate have a huge impact on the volatility of the world oil prices. Central Bank of Kenya ought to ensure that enough reserves are kept so that dealers are not prejudiced when there is a shortage of the currency thus making the prices quoted in the open tender system fairly reasonable.

Inculcating the provisions of the **Competition Act no. 12 of 2010** among the measures necessary that will help curb predatory practice of oil dealers is also advised as also a means of protecting both the oil dealer and the consumers. The Competition Act aforementioned came into effect on 1st august 2011, which almost one year after the Energy (petroleum pricing) regulations 2010 came to effect. Considering that the regulations came into effect prior to the Competition Act there may have been more gaps particularly in the area of determining what conduct may amount to be predatory as the regulations are limiting on what amounts to an offence. On the contrary the Competition Act is more elaborate in its definitions and criteria that it lays on

¹⁶¹ See preamble to the Competition Act.

establishing what conduct qualify to be predatory. Provisions within the Act may easily identify instances where the large multinational corporations may abuse their dominant positions to impose unfair prices on fuel products to the prejudice of other businessmen. Energy regulations under discussion in this work are more concerned with the maximum fuel pump prices and which concern mainly serves the consuming public. On the other hand, the Competition Act makes it an offence and prohibits the imposition of an unfair purchase or selling price which provision seems to address the concerns of both the marketers and consumers¹⁶². Sale of fuel below the cost can also amount to an unfair price. In my view it will be necessary to see more synergy in the application of such relevant legislation to regulate the trade in fuel pricing.

Further it is recommended that amending the current regulations should be a matter that ought to be taken into considerations particularly to make it more punitive to businesses that engage in restricted trade practices. Currently the energy regulations do not prescribe the penalty for persons engaging in hoarding of fuel commodities yet such practices have a tendency to disrupt the rules of demand and supply in the price formula. Specific provisions should be enacted to penalize hoarding of fuel which has become a notorious practice among retail suppliers of fuel and goes unpunished under the existing regulations. In the absence of any deterrent legislation the practice of hoarding will continue to hamper measures intended by the Energy (petroleum pricing) regulations 2010 to protect the interest of both the businesses and the consuming public.

By putting in place some of these proposals it will in the long run to ensure the overall efficiency of the fuel subsector and particularly in so far as the application of the Energy (Petroleum Pricing) Regulations 2010 is concerned. The recommendations proposed here will serve to improve the business environment for the oil marketers as well as reduce the suffering occasioned to the consuming public.

¹⁶² Section 24 of the Competition Act on Abuse of dominant position.

In conclusion, the Energy (petroleum pricing) regulations 2010 since their introduction seem to have had their fair share positives and negatives as has been observed in this work. As much as the law has to some extent tried to enforce some controls in the fuel sub sector as opposed to the trend in the past, a lot remains to be done to try and make the said law achieve the intended purpose for which it was enacted. We trust that the findings and the recommendations proposed in this work will be utilized as a means of enabling the said legislation achieve its objectives. Particularly it is also hoped that the proposals in this work will be adopted to address the shortcomings occasioned by these regulations and already highlighted in this work as a means to ease the suffering of the consuming public and foster the growth business firms in the oil subsector.

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