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"The processes need to be holistically managed."

TRANSFORMING AND LIBERALISING THE INDUSTRY: A SUMMARY

KEY INITIATIVES

Sapia members, together with the Minister of Minerals and Energy, Ms Phumzile Mlambo-Ngcuka, and her Department, are driving crucial initiatives to transform and liberalise the industry in line with the changes that are taking place nationally and globally.

The key initiatives relate to:

- Making the industry a true living example of an empowerment industry.
- Managing its liberalisation.

EMPOWERMENT

The first of these is being achieved through the 25% black empowerment target that is set out in the "Charter for the South African Petroleum and Liquid Fuels Industry on Empowering Historically Disadvantaged South Africans in the Petroleum and Liquid Fuels Industry". The Charter should be read as an integral part of this report. It is available on the Sapia website (www.sapia.co.za). The Sapia Chairperson comments on the progress that has been made in making the Charter a reality on page 10, and detail of some of the initiatives is set out on page 11.

The developing and signing of the Charter in the year 2000 was a major step forward. Of particular importance was agreeing with Government that a more effective way of bringing about empowerment would be for black shareholders to own shares in the integrated oil companies as opposed to seeking to grow smaller black owned oil companies until they represented 25% of the industry. The financing and long term success of these deals is now the key challenge facing both Sapia members and their actual and potential shareholders.

Sapia believes that the steps it is taking towards becoming an empowerment industry are essential to the future stability of the nation – and that these steps need to be followed by other industries. It is particularly heartening to Sapia that other industries are now also entering into charters.

The implementation of the Charter includes much more than ownership. Procurement, employment equity, capacity building and the creation of a supportive culture are also vitally important.

MANAGED LIBERALISATION

The second key initiative aims at removing, in a managed way, the complex web of regulations that have

constrained the industry for the past half-century. Some of the regulatory structures, though devised in a different era, still meet the social objectives of Government today – for example the fostering of small business and jobs in the service station industry. It is important that the liberalisation process should take into account national economic and social priorities. It is also important that the process should proceed in a holistic way, taking account of agreed priorities and of the reasonable interests of all stakeholders.

OTHER INITIATIVES

Other initiatives include environmental issues, notably improving the quality of products – the lowering of the level of sulphur in diesel and the phasing out of lead in petrol, where crucial decisions were made during the year – and the encouragement of rural development and poverty alleviation.

The combined challenge of attaining empowerment, liberalisation, environmental protection, rural development and upliftment will be a severe test for the industry. The processes need to be holistically managed – through well-considered interventions by both the industry members and Government.

THE ROLE OF GOVERNMENT INTERVENTION

Sapia, repeating what it said last year, believes that direct Government interventions are needed in only two circumstances:

- When a free market will not of itself necessarily result in the attainment of national strategic objectives e.g. black empowerment, setting of environmental standards and rural development.
- When there is not sufficient competition, e.g. when monopoly conditions are present.

Government interventions should be tested to ensure that they are required for one of the above reasons.

CURRENT ISSUES

A number of facets of the regulatory system are currently under review.

Some of these are driven by the need for the regulation of the industry to be valid in terms of the new competitions law and some are part of a desire to improve governance.

The most important step is a proposal to redraft the Petroleum Products Act (PPA) so as to enable the Minister of Minerals and Energy to promulgate regulations to replace some of the less formal regulatory arrangements of the past.

Various parts of the controlled pricing system are also being reviewed. Sapia believes that there is a need, in what will be a long transition period, to have a price and margin setting mechanism that is consistently applied, fully transparent and is fair to all stakeholders. The important proposed changes to the IBLC system meet these tests.

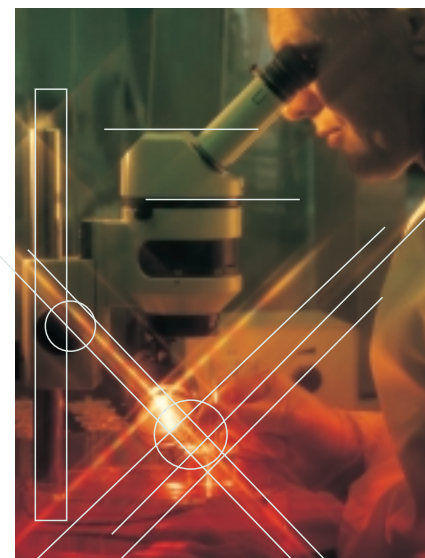
SAPIA'S POSITION ON MANAGED LIBERALISATION

Sapia and its member companies:

- Believe that it is important that all parties seek to maintain as stable a business environment as possible during the period of transition to a less regulated industry.
- Support the broad approach of adapting some of the regulatory mechanisms governing the liquid fuels industry in order to further Government's

social and other policy objectives, prior to moving into an environment of less Government regulation of the industry, while also fostering a climate of certainty and fair returns for investors.

- Support efforts to attain the 25% empowerment target spelled out in the Charter.
- Believe that it is important to the well being of the industry that, while regulation of prices and margins continues, this regulation enables fair returns to be earned by refiners, marketers and retail dealers, thus ensuring that the investment necessary for the development of the industry takes place.
- Welcome Government's commitment, expressed in the White Paper, to promoting a "climate conducive to reasonable profits and sustained investment in the liquid fuels industry".



- Believe that the continued existence and growth of the local refining and synfuels production activities is in the national interest. This means that there will be a need for Government and industry to seek mutually satisfactory ways to enable these activities to meet the various challenges they face, including the continuing need during this decade for large investments in environmental protection and related product quality improvements.
- Note Government's intention to redraft the PPA so as to enable the Minister to make regulations relating to the licensing and control of aspects of the business of both wholesalers and resellers. Sapia looks forward to working with Government in bringing about these important changes which will assist in ensuring better governance of the processes of regulating and managing the liberalisation of the industry. These processes will then be carried out in terms of an Act of Parliament rather than under the "ad hoc" arrangements of the past.

SAPIA CONCERNS

Sapia, however, had certain concerns on the detail of the proposals to amend the PPA and on the proposed regulations that were published for public comment by the DME in September 2001. These concerns included the following:

- The proposed amendments give the Minister a wide discretion as to how and for what purposes the delegated powers to regulate are exercised. The draft amendment Act does not, in the opinion of Sapia, adequately describe the objectives for which the proposed regulatory powers are to be used. The proposals as presently drafted may create uncertainty and therefore impact negatively on business confidence in the sector. They also create the potential for discrimination based on criteria that are not suf-

ficiently defined. Sapia believes that the merits of establishing a Petroleum Regulatory Authority for the purposes of carrying out the regulatory/licensing role should be evaluated.

- The resultant uncertainty and inability to plan effectively may adversely affect new service station development. New service station developments, for example, require substantial lead time and pre-planning, and investors cannot proceed with confidence in the absence of certainty that a licence will be granted if certain specific criteria are met.
- There are extensive and onerous requirements relating to the provision of information and registration of specific facilities, particularly for the holders of wholesale licences although all licence holders are affected. Sapia regards these requirements as impractical and unduly burdensome.

Sapia believed that the proposals required amendment to address these concerns amongst others and submitted comments to DME in which these points were raised. Proposals were made on how to overcome the concerns.

At the time of writing the revised version of the PPA Amendment Bill is still awaited. It is hoped that the revised draft will allay many of the concerns Sapia had on the 2001 draft.

THE RETAIL SERVICE STATION SECTOR

Sapia is willing to accept a limitation on the "vertical integration" of the industry. This means that oil companies would not be allowed to operate service stations, but would leave it to individual dealers to do so, provided that the limitation has the effect of reserving service stations for small and medium enterprises and black economic empowerment. Sapia believes that

chains of dealers also should similarly be prevented from "vertically integrating" upwards.

Further, the limitation should not be applied in a way that prevents the various arrangements being developed by oil companies with the specific purpose of advancing black economic empowerment. In order to protect tens of thousands of jobs, Sapia agrees that the ban on self-service at service stations should remain, at least while Government regulation remains in force. Once the market is deregulated, however, Sapia members believe that a ban on self-service might not necessarily have the desired effect of preserving jobs, since service stations unable to compete by cutting costs might be forced to close down.

THE RESTRUCTURING OF PETRONET

Sapia believes that while the pipeline network remains in the hands of a monopoly service provider, tariffs should be regulated in a manner which ensures equitable treatment, transparency and fair competition between all users and protects the interests of consumers.

It is expected that the Petroleum Pipelines Bill will cast light on government's intentions in this regard and will be published early in 2003.

CHANGES IN IMPORT REGULATIONS

Sapia accepts the changes made in the country's import regulations to allow for the import of LPG and to empower airlines to import jet fuel for their own use.