



MALTA RESOURCES AUTHORITY

Decision Notice 02/2013/ED

Decision of the 31st January 2013 issued in virtue of the Malta Resources Authority Act (Cap.423 of the Laws of Malta) to Liquigas Malta Ltd (C44954) and Gasco Energy Ltd (C44953) with regards to the proposals for amendments in the methodology and cost factors included in the LPG Price Mechanism applicable from 1st February 2013.

Whereas the Authority has established an LPG Price Mechanism in June 2010.

Whereas the Authority has received a proposal by Liquigas Malta Ltd (C44954) and Gasco Energy Ltd (C44953), (hereinafter 'Gasco-Liquigas'), for amendments to be made in the methodology and cost factors included in the LPG Price Mechanism for the year 2013 as per correspondence dated 29th August 2012, 20th September 2012, 06th November 2012, 16th January and 17th January 2013 (attached as doc GL 1, 2 ,3 4,5and 6 respectively) and the consultation meetings held on 31st July 2012, 28th August 2012, 27th September 2012, 3rd October 2012, 14th November 2012, 27th November 2012, 3rd January 2013 and 16th January 2013.

Whereas the Authority had issued the Decision of the 24th December 2012 to Gasco-Liquigas with regard to the proposals for amendments in the methodology and cost factors included in the LPG Price Mechanism applicable from 1st January 2013 (hereafter 'Decision Notice 03/2012/ED') and had also issued the Decision of the 10th January 2013 issued in virtue of the

Malta Resources Authority Act (Cap.423 of the Laws of Malta) to Gasco–Liquigas with regard to the Decision of the 24th December 2012 issued in virtue of the Malta Resources Authority Act (Cap.423 of the Laws of Malta) to Gasco–Liquigas with regard to the proposals for amendments in the methodology and cost factors included in the LPG Price Mechanism applicable from 1st January 2013 (hereafter ‘Decision Notice 01/2013/ED’).

Whereas the Authority had revoked by means of Decision Notice 01/2013/ED, the Decision Notice 03/2012/ED’ and had also by means of the same Decision directed Gasco–Liquigas to submit in writing its considerations regarding the LPG Price Mechanism for the further consideration of the Authority within eight (8) calendar days as from the date of that Decision.

Whereas the Malta Resources Authority has received the considerations in writing, made by Gasco–Liquigas, as directed in terms of Decision Notice 01/2013/ED by means of documentation dated and received on the 16th January and 17th January 2013 respectively, and following that, the Authority, has made its review and considerations on the matter.

In view of the Authority’s function to:

- regulate, monitor and keep under review all practices, operations and activities relating to energy;
- to regulate the price structure for any activity regulated by the Malta Resources Authority Act and where appropriate to establish the mechanisms whereby the price to be charged for the acquisition, production, manufacture, sale, storage and distribution thereof is determined;

the Authority is hereby issuing this Decision.

(1) Projected Operating Costs

Gasco-Liquigas have requested the inclusion of the projected operating costs as detailed in the aforementioned proposal in the LPG Price Mechanism for the year 2013.

After due consideration, the Authority has approved the inclusion of these costs as apportioned to the regulated refillable and portable LPG cylinder sector (including the applicable finance costs), subject to the conditions outlined below, and in view of the reason that they are pro rata similar to the most recent audited accounts (period ending 30th September 2012) and hence are considered to be real costs incurred by Gasco-Liquigas to carry out the operations of importation, storage and filling of LPG in portable refillable cylinders. This inclusion is subject to the following conditions being also met by Gasco-Liquigas:

- (1) To submit by the end of October of this current year and of each subsequent year thereafter, an annual total cost and total volume forecast for the following calendar year for the Authority's evaluation, review and approval ; where said total cost and total volume is to be also unbundled between the portable and refillable cylinder segment and other segments and
- (2) whereby the average cost per tonne for the portable and refillable cylinder segment for the years 2014 and 2015 and subject to the exceptions in Condition (4) hereunder, is not to exceed the average cost per tonne as established hereunder in Condition (3) for

2013 after being adjusted for inflation as established by the Harmonised Index of Consumer Prices ('HICP')¹ movement year on year ending September of each year;.

- (3) Hence, for the purpose of Condition (2) above , the average cost per tonne is being established by dividing the unbundled operating costs of portable and refillable LPG in cylinders (excluding depreciation, rent and interest) for the year 2013 and the projected sales volume for 2013 as detailed in the Gasco-Liquigas proposal and as calculated in Annex A; and
- (4) Notwithstanding Condition (1) above, extraordinary costs that may be incurred, such as the dismantling costs of the Qajjenza Plant, new costs due to any change in the business model such as direct distribution, or new costs due to new business initiatives shall be included provided that reasonable justification is provided beforehand by Gasco-Liquigas and that approval by the Authority for the inclusion thereof is requested by Gasco-Liquigas and the required approval is given by the Authority before such extraordinary costs are incurred .
- (5) Notwithstanding condition (3) above , in the case that Gasco-Liquigas sales volume of refillable and portable cylinders decreases by 10% or more, the Authority after considering the impact on the profitability and sustainability of Gasco-Liquigas, may approve the revision of the projected sales volume that is used to calculate the average cost per tonne for the purpose of Condition(2) above.

The reason for the above conditions is to ensure that Gasco-Liquigas maintain a realistic and efficient operational cost base and to safeguard consumers of LPG sold in portable refillable cylinders from paying, via its retail price, for unduly high operational costs.

¹ as published by the National Statistics Office ('NSO')

(2) Use of Platts Monthly Average Price instead of the consignment Invoice

Gasco-Liquigas had originally requested that the raw material expense (product cost) included in the LPG Price Mechanism is to be based on the average international market price (as published in the Platts Marketscan) of the last week of each month plus an additional \$70/tonne premium instead of using the actual consignment cost. Subsequently Liquigas amended this request to continue using the actual consignment invoice value with the undertaking that it should be within a price band of plus or minus 5% of the sum total of the LPG average international market price (average FOB West Med Platts) during the month of purchase, as published in the Platts Marketscan, plus an additional \$70/tonne premium.

After due consideration, the Authority has decided to accept the use of the actual consignment invoice to be included in the LPG Price Mechanism. The invoice price must not exceed by more than 5% of the sum total of:

- A. the average West Med FOB price for LPG for the period of seven (7) working days made up of the three (3) working days prior to the date of bill of lading, the day of bill of lading and the three (3) working days after the bill of lading of the consignment covered by said invoice; and
- B. the actual premium paid, which is to reflect the primary transport and supplier's charge and which must be supported by the relevant documentation as may be applicable.

For the purpose of para (A) and (B) above, Gasco-Liquigas are to submit to the Authority in respect for each consignment:

- a) copy of invoice
- b) copy of documentation in support of premium paid (para (B) above)
- c) copy of bill of lading
- d) copy of West Med FOB price data for relevant period as established per para (A)above;
said data would be subject to verification by the Authority at its sole discretion.

The Authority is of the view that these measures will ensure price transparency in the LPG price mechanism and incentivise an efficient purchase practice.

(3) The 5% annual cost reduction target requirement

Gasco-Liquigas is requesting that the 5% annual cost reduction target requirement on their operating costs is removed from the LPG Price Mechanism.

The Authority has duly noted that presently the operations of the Benghajsa Plant are efficient and that furthermore proper safeguards have been put in place as detailed in the Conditions set in Section (1) above, and hence it is being decided that a continuation of an annual cost reduction target would be counter to the principle of fair pricing as specified in the 'LPG Price Review' of June 2010 and is thus approving the removal of the 5% annual cost reduction target requirement on their operating costs.

(4) Expense Apportionment

Gasco-Liquigas had originally requested that the non-specific expenses included in the LPG Price Mechanism are to be apportioned as 95% on cylinders and 5% on bulk, then revised its request so that non-specific costs are apportioned in the ratio of the respective apportioned direct costs of the cylinder and bulk segments.

Following the Authority's request, Gasco-Liquigas have unbundled the costs of storage and filling of gas cylinders.

After reviewing the said unbundling and allocation of costs, the Authority is of the view that the methodology used is transparent and fair and is accepting to use the said methodology for the allocation of costs and that of the resultant apportionment of non-specific costs, which non-specific costs, are to be apportioned in the ratio of the respective apportioned direct costs between the two segments of portable refillable cylinders and that of other segments.

(5) Rounding

Gasco-Liquigas have requested that the price resulting from the Price Mechanism is to be rounded to nearest five (5) euro cents instead of to the current nearest ten (10) euro cents.

The Authority after due consideration has determined to accept that the price resulting from the Price Mechanism is to be rounded to nearest five (5) euro cents as it is more precise.

(6) Increase in the Maximum Allowable Mark up

Gasco-Liquigas have originally requested an increase in the maximum allowable mark-up from the current €41/tonne to €140/tonne and then revised it down to €95/tonne.

The Authority reviewed the documentation submitted by Gasco-Liquigas on the matter (as per Doc GL5 showing ROCE and GL6 showing WACC) and is of the view that the Small company risk premium and the Execution risk premium appear to be incompatible with the broad thrust of modern corporate finance theory. Furthermore after considering the present Full Cost Recovery Price Mechanism and in particular the actual financing arrangements of Gasco-Liquigas, the Authority has determined that the maximum allowable profit mark-up in the LPG Price Mechanism is to be increased from Euro forty one (€41) per tonne to Euro seventy seven (€77) per tonne.

Mario P. Galea

Chairman

Malta Resources Authority