



MINISTRY OF PLANNING, LANDS, AGRICULTURE, HOUSING AND INFRASTRUCTURE

PUBLIC DISCUSSION PAPER

THE REGULATION OF THE FUELS MARKETS IN THE CAYMAN ISLANDS

1. Preamble

The Cabinet has decided to enact new legislation to establish a multi-sector regulatory agency to be known as Office of Competition and Regulation, (the Office, OCR) which will assume the responsibilities and functions currently carried out by Information Communications Technology Authority (ICTA) and the Electricity Regulatory Authority (ERA). For the avoidance of doubt, ICTA and ERA will cease to exist but the functions of OCR in the ICT and Electricity sectors will be exactly those that are set out in the ICTA and ERA Acts and ascribed to ICTA and ERA respectively.

Cabinet has also decided that OCR will assume the economic regulatory responsibilities currently discharged by the Water Authority (WAC). These responsibilities are largely set out in the Water Authority Law, The Water (Production and Supply) Law and the Wastewater Collection and Treatment Law.

The historical opacity of the pricing mechanism used by the petroleum products marketing companies (which is a key determinant of their economic operations locally) has been cause for much concern in recent years, so in order to provide rigorous, OCR will be assigned responsibility for the fuels market. A phased (or two stage) approach is being taken in regards to mechanism to be put in place for such a regime.

As a first step, amendments to the Dangerous Substances Handling and Storage Law have been enacted which require the industry to provide the Chief Petroleum Inspector with specific pricing and cost information that will enable an assessment of the costs at every stage of the supply chain. The second stage will be the enactment of a Fuels Markets Bill which will, inter alia, provide for the OCR to analyse the data to assess the reasonableness of the retail prices, assess the state of competition in the fuels markets and to take such action as is necessary to promote and sustain fair competition in the markets.

Strategically, the operation of the Petroleum Inspectorate (PI) will be fully integrated into the OCR and will be positioned to address a broader spectrum of the fuel sector than currently obtains. To this end, the Dangerous Substances Law will be further amended to (i) expand the remit of the CPI to “all fuels”; (ii) rationalise the relationship between the Chief Petroleum Inspector and the Office, a key consideration being that the Board of the Inspectorate would be the Board of the Office; and (iii) establish OCR as the agency with statutory responsibility for that law thus making the PI a functional unit within OCR; and (iv) the statutory position of “Chief Petroleum Inspector” will be renamed to reflect the wider scope of responsibilities for the sector”.

This paper discusses the policy issues that will guide the development of the legislation for the Fuels Market.

2. Policy framework

The Draft National Energy Policy of the Government of the Cayman Islands (29 March 2013) provides guidance in relation to Fuel Products. The relevant sections are reproduced and slightly restated below.

Fuel Products Policies

It is the Government’s policy that fuel products be imported and used in the Cayman Islands according to economic efficiency, security of supply, public safety and health, and environmental sustainability.

The Government recognizes that imported fossil fuels are likely to represent the major primary energy resource for electricity, transportation, and stationary uses of energy in the Cayman Islands for the foreseeable future. The Government is, however, committed to promoting the introduction of alternative and cleaner fuels, fossil-based and otherwise, consistent with international commitments , into the economy of the Cayman Islands.

Considering the above, it is the Government’s policy to:

1. Ensure sustainable handling, storage, and off-island disposal of waste oil
2. Ensure a secure, reliable, and competitive supply of fuel products
3. Indefinitely postpone any assessment of the viability of nuclear energy for power generation!
4. Ensure quality of aviation jet fuel and kerosene!
5. Carefully consider the viability of Heavy Fuel Oil.

Fuel Products Policy 1: Ensure sustainable handling, storage, and off-island disposal of waste oil

To ensure sustainable handling, storage, and off-island disposal of waste oil, it is the Government's policy to:

- Maintain existing efficient practices to collect and handle waste oil
- Require all private operators that generate waste oil to follow best practices for handling and storage of waste oil, ensuring safety for the environment, and making off-island export possible
- Provide information on sustainable waste oil handling and storage, as a complement to requirements
- Define a backstop option for waste oil environmental emergencies, to ensure a reliable access to collection and disposal systems, and if necessary cooperation with overseas entities, in the event of an emergency
- Encourage private operators to collect and export waste oil for off-island recycling and disposal, while leaving the recycling business to free market forces
- Ensure compliance with international agreements on the export of hazardous waste.

Fuel Products Policy 2: Ensure a secure, reliable, sustainable, and competitive supply of petroleum products

To ensure a secure, reliable, and competitive supply of petroleum products, it is the Government's policy to:

- Maintain efficient procurement and storage practices, including hurricane risk insurance, adequate storage capacity, and fuel hedging contracts
- Maintain and improve transparent and competitive fuel procurement processes for power generation, possibly combined with additional storage capacity to increase the opportunity to reduce costs
- Consider increasing the resilience of fuel supply to national disasters or emergencies
- Consider mandating the procurement of ultra-low sulfur diesel
- Treat alternative fuels according to the principles of technology neutrality and pursuit of net economic benefits—Liquefied Natural Gas (LNG) for power generation, CNG, and LPG might be considered if and when they become viable for the Cayman Islands.

Fuel Products Policy 3: Indefinitely postpone any assessment of the viability of nuclear energy for power generation

It is the Government's policy to indefinitely postpone any assessment of the viability of nuclear energy for power generation, considering the unfavorable economics of Small Modular Reactors (SMRs) at present and for the foreseeable future, as well as problems of regulatory competence, accident liability, and handling of spent nuclear fuel.

Clause 23(4)(c)(vi) of the ERA Law, which states that the primary source of energy shall in no circumstance include the use of nuclear fission for the generation of electricity, shall remain unchanged.

Fuel Products Policy 4: Ensure quality of aviation jet fuel and kerosene

To ensure quality of aviation jet fuel and kerosene, it is the Government's policy to:

- Maintain industry test standards for aviation jet fuel and kerosene
- Keep current procurement practices for aviation jet fuel and kerosene under review to ensure practices that produce optimal results
- Ensure that fuel suppliers comply with set international regulatory standards for quality control.

Fuel Products Policy 5: Carefully consider the viability of Heavy Fuel Oil

It is the Government's policy to:

- Keep under review the assessments of the options of using HFO compared to diesel for power generation would create net economic benefits, considering fixed (capital) and variable (operational) costs
- Decide whether the environmental risk of importing HFO instead of diesel fuel is acceptable.

While a few of the policy objectives are currently being met, OCR will be the agency with the key responsibility for the implementation of these policies and to this effect appropriate provisions will be made in a Fuels Markets Bill or by way of further amendments to the Dangerous Substances Law to provide the legal framework to give effect to these policies. The Fuels Markets Bill will also address the concerns for environmental protection and other matters relevant to the sector.

Legal Framework

Object

The Government recognises that the availability of fuels and in particular petroleum products at reasonable prices is vital to the national economic wellbeing and general welfare of the Islands. The object of the legislation is to provide a framework for the management, regulation and supervision of the fuel markets in order to secure optimal prices for consumers while ensuring that market operations is consistent with international best practices and standards for safety and environmental protection.

This law will therefore be the sector law for the fuels market and will reflect the policy where, as a key driver of economic activity, the market will rely on fair competition to deliver product safely and in environmentally sustainable manners at the lowest prices to consumers and that price regulation will be introduced only if the Government is satisfied that there is market failure. In this regard, the Cabinet and the Office will have complementary functions “to ensure a secure, reliable, sustainable, and competitive supply of fuel products”.

“Fuel(s)” will continue to be assigned the broad definition as provided in the DS Law with amendments over time to reflect the other types which find applicability to the country. The Government will seek to introduce, continue and enhance policies as required and as such the objectives of the Bill are to—

- (a) ensure that the fuels supplies of the Cayman Islands is adequate, reliable, efficient and economical for the country and the consumers;
- (b) protect the public’s safety, health and the environment in all fuels supply operations and installations;
- (c) protect the occupational safety, health and welfare of people working in the fuels industry;
- (d) ensure equal access to all fuel products of specified quality at competitive prices for all consumers;
- (e) prevent discrimination or preferential treatment of any participant, and to prevent monopolistic control of any segment of the chain of supply;
- (f) create favourable conditions for new participation and investors in order to improve and/or expand the infrastructure of the chain of supply in the Islands

Functions of the Cabinet:

Cabinet has the duty to establish and maintain policies designed to ensure that the act and business of importing, exporting, re-exporting, shipping, transporting, processing, refining, storing, distributing, marketing, and selling fuels as well as operations and activities of persons, firms and entities engaged in the fuels industry shall be carried out in a manner that is consistent with the public interest, so as to attain the following objectives and purposes:

- 1) To assure that the country has a proper adequate and continuous supply of fuel products under the most economic and competitive terms possible considering all available sources of supply;
- 2) To assure that the fuel industry, as a business vital to the national interest, operates under conditions of orderly, fair and economic competition;
- 3) To assure the public of reasonable prices for fuel products considering (i) the international price levels and after allowing for proper and reasonable cost of importing, shipping, transporting, processing, storing, distributing, marketing, and selling fuel products in The Cayman Islands, (ii) for a fair and reasonable return to market participants; and (iii) to prevent collusive practices in the industry, particularly as to prices;
- 4) To facilitate the introduction of alternative fuels [such as LNG, biofuels] into the economy if economically feasible and technically [environmentally] reasonable; and
- 5) To facilitate investments by fuel supply companies in a manner which promote fair competition and economic activity

Functions of the Office:

The Office shall have supervision and jurisdiction over all persons, corporations, firms or entities engaged in the business of importing, exporting, trading, re-exporting, shipping, transporting fuels; storing, marketing, distributing, or selling, both at wholesale and retail, any fuel or refined fuel products, and shall monitor, regulate and supervise the operations and activities of said persons and entities and in doing so the Office's functions are:

- 1) To implement national policy objectives in the sector as set out in published directions issued by Cabinet pursuant to this law
- 2) To promote fair competition
- 3) Consumer protection through the exercise of its regulatory powers
- 4) To promote and facilitate the introduction of alternative fuels into the economy
- 5) To discharge duties conferred on it by this law [or any other law]
- 6) To appoint the Chief Petroleum [Fuels] Inspector pursuant to the DSL

In the discharge of its functions the Office's duties include:

- 1) To set conditions which would accomplish the purposes of this Law, under which persons can engage or continue engaging in the business of importing, exporting, re-exporting, shipping, transporting, storing, distributing, marketing or selling fuels,;
- 2) To monitor the global fuels markets and in particular the importation of fuels into the Cayman Islands in order to understand the market forces which impact on the importation and pricing of fuels delivered to the Cayman Islands;
- 3) To monitor, supervise and regulate the operations and trade practices of the industry in order to encourage orderly and fair competition, prevent monopolies

- and collusive practices within the industry, having due regard to the ecological and environmental needs of the Islands;
- 4) Where appropriate and if considered to be in the public interest to mandate and regulate arrangements for infrastructure sharing
 - 5) To facilitate investments in the fuels sector to secure efficiency, competitive prices and growth in the economy generally
 - 6) To maintain a data base of all fuels imported into the Islands, and as near current as possible an inventory of “bulk” storage
 - 7) To conduct market analyses to assess the effectiveness of competition in the markets;
 - 8) To gather and monitor prices of fuel products at every stage of the supply chain to the retail level and in doing so maintain a data base of all costs and prices of fuel products.
 - 9) To advise Cabinet on the effectiveness of competition in the market and if there is market failure to recommend appropriate measures;
 - 10) To set prices pursuant to regulations
 - 11) To facilitate in the carrying out of its functions a sufficient plurality of operators in the fuels market at the wholesale, marketing and retail levels;
 - 12) To take such action, under this law or any other law, as is necessary to secure the safety of installations where fuel products are stored, handled, transported or dispensed to the public
 - 13) To take into account the protection of the environment
 - 14) To do and perform any and all such acts as may be necessary and proper to carry out the purpose of this Act.

Revenues of the Office:

The OCR fuel sector oversight activities shall be funded by the sector from revenues derived from its operations.

Competition provisions:

The Bill will provide an especial duty on the Office to develop and implement policies designed to promote competition in the fuels market and in doing so it shall be required to continually assess the state of competition in the market. The expressed policy intent is that the Office should do all that it can to secure robust competition in the market and in the discharge of these responsibilities may introduce such measures which it considers to be best calculated to have the effect of increasing competition.

In this regard, the Office will have duties in respect of Merger Control in the sector for which it has responsibility. The OCR Law will provide that any change in control that would result of a merger of the operators in the market must have the prior approval of the Office. That law will set out the procedures to be followed to obtain such approvals as well as the questions to be determined and principles for appraising the request. In considering

such applications the Office shall form an opinion whether the proposed change of control of a licence:

- (a) would have, or be likely to have, the effect of substantially reducing competition in the market in The Cayman Islands; and
- (b) whether such change would be likely to have an effect contrary to the public interest.

In granting its approval, the Office may, if it finds that (a) or (b) are likely outcomes of the merger/change in control, attach conditions to its approval to mitigate these impacts, which may include provisions to facilitate “*First Rights or Refusal*” to local, independent groups to enter and participate in the market.

Access to information:

The Office will have the authority to access any information that it requires for the carrying out of its functions from any government department, government agency, importer, wholesaler, retailer or any other person who the Office reasonably believes may have access to the information it requires.

Confidentiality:

The Office shall have a duty to keep confidential any data or information provided to it which the “owner” [giver] of such information marks as confidential or is proprietary or commercially sensitive. This will complement existing provisions in the Dangerous Substances Law and FOI Law.

Price controls:

On the issue of price controls, the Office will have a duty to advise the Cabinet on matters relating to the state of the market and, should it determine that there is market failure in any market segment, to recommend to Cabinet the action to be taken to protect consumers which may or may not include price controls.

Disposal of waste/used fuels

Provisions for disposal of waste and used oil shall complement existing provisions and practices currently in place under the Public Health Law. OCR oversight in this regard, in addition to provisions under the Dangerous Substances Law, may prescribe based on economic principles and assessment, rules for guidance of this subsector. Waste oil is oil that has never been used because it has been compromised, typically through contamination, and is now unsuitable for its original purpose. Examples of waste oil include oil spill clean-up, the bottom sediment of oil tankers after cleanout, and oil that has been contaminated through leaking containers. Waste oil can never be used, either through recycling or cleaning.

Used oil is oil that has been used previously, and as a result of that, is now contaminated by impurities, either chemical or physical. Examples of used oil are old transmission oil, motor oil, brake fluid, hydraulic oil and gearbox oil. Used oil is a recyclable commodity, and as such, can be stored for recycling, reuse or disposal. Used oil is not considered to be a waste product.

Both waste oil and used oil require proper recycling or disposal techniques which are set out by government bodies. This is to avoid illegal dumping and to help protect the environment.

Used oil falls under 'regulated waste products', whereas waste oil is considered to be a hazardous waste. As such, disposing of waste oil has far more legal implications and must be handled in accordance with the Dangerous Waste Regulations. Waste oil is considered to be a dangerous substance, and requires speedy and proper disposal. Waste oil must be handled using licenced disposal and storage facilities with permitted treatments.

The Dangerous Substances Law has provisions for the Cabinet to make regulations in regard to the handling storage, transportation of dangerous substances and which would therefore address the issue of waste oil.

Similar provisions although, used oils are not explicitly referred to, are provided in the Public Health Law.

To avoid any lacunas developing in the future, in the wider context of the definition of "fuels", the Fuels Bill will provide for the Cabinet to make regulations for the handling and disposal of waste and used fuels.

Administrative Fines:

The power of the Office to impose administrative fines for breaches of the competition rules will be maintained in this sector.

Enforcement

The PI acting under powers granted by the Dangerous Substances Law shall be the enforcement arm of the Office.

Penalties:

The Dangerous Substances Law has penalty provisions applicable to the enforcement actions.

Penalty provisions for (i) "failure to provide information" to the Office under its information gathering functions; and (ii) breaches of Administrative Determinations of the Office will be addressed in the Law.