THE OIL PRICING CRISIS; A REVIEW OF THE CURRENT LEGAL REGULATORY PRICING OF PETROLEUM PRODUCTS IN KENYA

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MAY 2011

DECLARATION

"I declare that this thesis is the work of **AUGUSTINE SIAMITO SEKEYIAN** alone, except where due acknowledgement is made in the text. It does not include materials for which any other university degree or diploma has been awarded."

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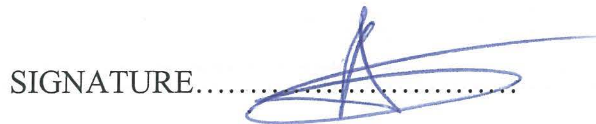
SIGNATURE……………………………… 

DATE……………………………………… 17th May 2011

DEDICATION

I dedicate this dissertation to my parents who have spared nothing to ensure that I followed my dreams….

And to the young, Fervent African scholars overflowing with idealism…..

Yes, I am a dreamer. For a dreamer is the one who can find his way by moonlight, and see the dawn before the rest of the world.

-Oscar Wilde-

APPROVAL

"I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate in scope and dissertation in partial fulfillment for the award for the Degree of Bachelor of Law Kampala International University."

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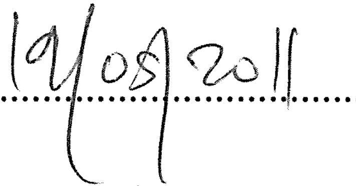

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ABBREVIATIONS

ERC	-	The Energy Regulatory Commission
MOE	-	The Ministry of Energy
OECD	-	Organization for Economic Cooperation and Development
PRC	-	Petroleum Refining Costs
RTPA	-	The Restrictive Trade Practices, Monopolies and Price Control Act
UNDP	-	The United Nations Development Programme
UNEP	-	The United Nations Environment Programme

LIST OF STATUTES

The Electric Power Act

The Energy Act

The Petroleum Act

The Restrictive Trade Practices, Monopolies and Price Control Act

The Standards Act

LIST OF CASES

David Onyango Oloo vs. The Attorney General

Hoffman- La Roche vs. Commision

Munn vs. Illinois

Nebbia vs. Newyork

Nordenfelt vs. Maxim Nodenfelt Guns & Ammunition Co.

Petrofina (Great Britain) Ltd vs. Martin

U.S vs. Darby

United Brands vs. Commission

West Coast Hotel Co. vs. Parrish

Zuechner vs. Bayerische Vereinsbank AG

ABSTRACT

Energy occupies a pivotal position in any country's search for economic development. The availability of reliable supply of energy spurs economic development through raised levels of productivity, creation of employment opportunities and income generation. It is indispensable to point out that one of the key sources of energy in Kenya is petroleum and petroleum products.

The determination of the price of petroleum products in Kenya has been left to the international market forces in the petroleum sub-sector which are governed by profit-driven multinational companies. This renders Kenya very vulnerable, hence the need for control and regulation of the retail prices of petroleum products.

The citizenry needs to be cushioned from the constant price hikes which are usually rippling effects of the dynamics of the international community, for example, the political instability in the Middle East. The government should therefore avail legal mechanisms for stabilizing petroleum prices for purposes of protecting consumers and checking on arbitrary priced fluctuations.

The regulatory framework of the retail prices of petroleum products is the province of this research paper. This paper seeks to examine the sufficiency, or lack thereof, of the existent regulatory framework. Hon. Kiraitu Murungi, the energy Minister, with regard to his power to control fuel prices, made a declaration that Kenya should maintain a market-oriented economy. This, in essence, renders the pricing of petroleum products at the mercy of multinational corporations and the dynamics of the international market.

This proposed study also seeks to investigate the role of the government in protecting the interests of the consumer, the investors and other stake holder interests in our capitalist economy. While operates in a free market economic and business environment, this study proposes to determine whether this environment favourable to the consumer or not.

Another facet of the regulatory framework that this research proposes to investigate is the implementation of and the observance of the principles of fair competition in the petroleum sub-sector.

TABLE OF CONTENTS

DECLARATION i

DEDICATION ii

APPROVAL iii

ACKNOWLEDGEMENT iv

ABBREVIATIONS v

LIST OF STATUTES vi

LIST OF CASES vii

ABSTRACT viii

TABLE OF CONTENTS ix

CHAPTER ONE 1

THE PRICING OF PETROLEUM AND PETROLEUM PRODUCTS IN KENYA 1

1.1 Introduction 1

1.2 Background 2

1.3 Statement of the Problem 4

1.4 Justifications for the Study 4

13 Objectives of the Research Paper 5

General objectives 5

Specific objectives 5

1.6 Assumptions 6

1.7 Research Questions 6

1.8 Research Methodology 7

1.9 Scope of the Research 7

1.10 Hypothesis 8

1.12 Literature Review 8

1.13 Chapter Breakdown 14

CHAPTER TWO 16

THE PRICING OF PETROLEUM AND PETROLEUM PRODUCTS IN 16

2.1 Introduction 16

2.2 The Kenyan Petroleum Sub-sector in Context 17

2.3 The Supply of Petroleum in Kenya 18

2.4 Factors that Affect the Supply and Retail Price of Petroleum 19

2.4.5 Government Taxes 19

2.4.6 The Implication of Taxation on the Pricing Mechanism of Petroleum 21

2.5 Conclusion 23

CHAPTER THREE 26

AN APPRAISAL OF CURRENT COMPETITION LAW AND POLICY 26

3.1 Introduction 26

3.2 The case for Competition Law 28

3.3 Structure of the Kenya Petroleum industry market 30

3.4 Enumeration of Competition Law and Policy in Kenya 35

3.5 Conclusion 38

CHAPTER FOUR 40

THE CURRENT REGULATORY FRAMEWORK OF THE 40

RETAIL PRICES 40

4.1 Introduction 40

4.2 The Energy Act 43

4.3 Shortfalls of the RTPA 49

4.4 The Petroleum Price Regulations, 2009 56

4.4 Conclusion 59

CHAPTER FIVE 64

CONCLUSIONS AND POLICY RECOMMENDATIONS 64

BIBLIOGRAPHY 68

CHAPTER ONE

THE PRICING OF PETROLEUM AND PETROLEUM PRODUCTS IN KENYA

1.1 Introduction

A professor was once explaining to his class the operations of a market. He told his students of a hypothetical world in which there were only two products; food and clothes. He drew a left vertical line to represent food, and a bottom horizontal one for clothes. In between, he would sketch a slope, which he called "demand curve" to illustrate how people demand more clothes at the expense of food, and vice versa.

"Be sure," he implored sagely, "that the demand curve touches neither the vertical nor the horizontal axes. It touches the vertical axis, you have a well-fed nude; the horizontal, you have a well-dressed corpse."

The above illustration sheds light on the perilous situation the Kenya economy is in, particularly with regard to our national petroleum policy. Like any other commodity, oil is the subject to the dynamics of supply and demand.

Energy is fundamental to sustainable economic growth and development in any country. It is for this reason that laws are passed in many a country to protect the nation's interests in this sector. The cost of energy determines many, if not all, aspects of life. It is therefore important that this essential ingredient of any nation's life be secure.

Energy security spurs economic development. Therefore, along side our decidedly free- market environment; we must be sure that couched in our national petroleum obey are safety measures- relevant Laws, Legal Frameworks and Regulations- that will ensure the hypothetical demand curve touches neither of the axes.

Crude oil is one of the modem world's most actively traded commodities, Petroleum is-Kenya's major source of commercial energy and has, over the years, accounted for approximately 67 per cent of the country's industrial and commercial energy requirements[1]. Further, petroleum

[1] Bhagavan, MR (1999) Petroleum marketing in Africa: Issues in Pricing, Taxation and Investment, page 24

remains without substitute as the only source of energy for the transport industry. Presently, petroleum accounts for approximately 22 per cent of the national energy consumption[2].

Owing to its prominent position in Kenya's industrial and commercial structure, the prices of petroleum products remain the major drivers of inflation. The country spends up to 4 per cent of the Gross Domestic Product (GDP) in the importation of petroleum products annually.[3]

Kenya is not a producer of petroleum and she imports all the petroleum consumed chiefly from the Persian Gulf area. Most of it is imposed as crude oil before it is refined at the petroleum Refineries Limited (TPRL) in Mombasa and then transported inland by pipeline, road and rail.

This fact wakes the Kenya petroleum subsector on the first level vulnerable to the dynamics of the international oil market in its bid to maintain sustainable, cost effective and affordable supply of oil. Secondly, that the local price of oil and oil products has largely been left to profit—driven multinational companies is great cause for concern. This renders Kenyan retail consumers very vulnerable.

Against this backdrop, many legal and regulatory concerns come to the fore. Utmost is the buttressing of the consumer from the arbitrary price fluctuations endemic to the Kenya petroleum industry.

1.2 Background

In her Sessional Paper No. 10 of 1965[4], and indeed in her approach to commerce, Kenya has always been a free-market economy meaning, in essence, that there is little or no government presence, in the form of regulation, in day-to-day commerce. This is the subsisting situation in the petroleum sub-sector, hitherto the liberalization of the industry in October 1994. The

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[2] Ibid, page 23

[3] Bulletin of the institute of economic Affairs, Issue No.41 November 2000

[4] Sessional Paper on African Socialism and its Application to planning in Kenya.

government retained only the responsibility of ensuring the security of supply of petroleum products[5].

With the liberalization of the petroleum industry, the pricing and marketing of petroleum and petroleum products now vests wholly in the hands of the private sector.[6] The happenings, however, of the recent past have shown us that we must be careful not to assign to this progress the attributes of a victory. The local petroleum market has, in the recent year, been beleaguered by dramatic increases in the retail prices of petroleum and petroleum products. This is a ripple effect of the situation in the international oil market where the price of crude oil hit an all-time high of US $I39.I 2 per barrel in June 20O8.[7]

It is apparent that the citizenry needs to be cushioned from the constant price hikes, usually rippling effects of the dynamics of the international community. The determination of the price of petroleum products in Kenya has been left to the international market forces in the petroleum sub-sector which are governed by profit driven multinational companies. This renders Kenya very vulnerable, hence the need for control and regulation of the retail prices of petroleum products.

The government should and has in fact made efforts to avail legal mechanisms for stabilizing the pricing of petroleum and petroleum products. The government seems to be aligning itself with the position that in order to effectively protect the Kenyan consumers and check on arbitrary price fluctuations, the retail price of petroleum and its products should be set by law.

Kenya's free-market economy stance has shown that it cannot realistically protect the interests of consumers. This proposition rings true and relevant in view of recent events where, even after a dramatic fall in global oil prices, with the prices falling by as much as 50%, there was little change in the retail prices in the local market.[8] This is thanks, largely; to the profit-driven

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[5] Timothy Ranja, Economic and Social Research Foundation: Globalization and East Africa, working Paper Series No. 12

[6] Ibid

[7] Seewww.bbc.co.uk/news/business.httml (last accessed on 30th April 2009)

[8] Ibid

multinational oil companies. These trends have become altogether too familiar to the Kenyan citizens. Change is long overdue.

1.3 Statement of the Problem

The researcher finds the facts aforementioned a sure basis upon which the proposition that the state of Kenya's petroleum sector is wanting may be made. The national petroleum policy lacks the ability to stabilize the prices of petroleum products and also check on the arbitrary pride fluctuations for purposes of the protection of the consumers. Herein lies the crux of this dissertation.

It is imperative that the interests of the consumer be given utmost protection. The existing legal and regulatory framework in the petroleum sub-sector falls short in this regard. Further, the local oil market is constantly being manipulated by profit-driven multinationals, thanks to deficiencies of the R.T.P.A.

1.4 Justifications for the Study

Karl Marx is often quoted as having said that history repeats itself. This statement holds insightful significance to the researcher, and particularly, the proposed regulations in respect of the retail pump price of petroleum products published by the Energy Regulatory Commission.

In the period preceding October1994, the government actively regulated the oil industry, with very little involvement by the private sector. This regulation entailed the government's involvement in the procurement, distribution and pricing of petroleum and petroleum products in the country.

This period was characterized by inefficiency in the petroleum industry. Shortage of oil and oil products in the retail outlets was characterized by long queues at petrol stations. The demand for Liquefied Petroleum Gas (LPG) could simply not be met by the existent oil companies. The petroleum industry was practically on its knees. This was the bleak reality of the era of government price control.

It is imperative that the Minister of Energy reflects on this history before assenting to the said regulations proposed by the ERC. It is for the common interest of any society that we do not digress to the unmeasured inefficiency exhibited during the era prior to the liberalization of the petroleum industry.

It is with this in mind that the researcher embarks on writing this dissertation. It is imperative that a reasonable and practical proposal be made towards the resolution of the problems associated with direct price control by creating a legal framework that manages to ensure that there is efficiency in the petroleum industry.

13 Objectives of the Research Paper

General objectives

The research general objective is to dissect the current oil pricing crisis and the role that our regulatory framework plays in mitigating the crisis. This ,the researcher will do by analyzing the factors that influence the retail price of oil and oil products with the expected end of recommending a means of cushioning the-Kenyan consumers.

Specific objectives

The researcher lists these thus:

1. To examine the legal and policy framework governing the petroleum industry in Kenya;

2. To evaluate the institutional framework and effects in the energy sector;

3. To examine the new regulatory rules and implications in the energy sector.

4. To establish requisite market policies in the energy sector.

1.6 Assumptions

The study is based on the following assumptions:

1. Since the liberalization of the petroleum industry, the Kenyan oil market is founded on the tenets of free market competition operating wholly on the basis of sound commercial principles.

2. The Kenyan oil market is dominated by profit-driven

3. The pricing and marketing of petroleum and petroleum products is a province exclusive to these multinationals.

4. The oil companies in Kenya's oil marker do not observe the principles of free market competition.

5. There are both fiscal and non-fiscal barriers to the entry of new players into the petroleum industry. .

6. Oil and oil products are a major source of government revenue in the form of heavy taxes and levies imposed on them.

1.7 Research Questions

The researcher sets out to answer the following questions:

I. How can the-Kenyan citizenry be legally cushioned from the constant hikes on the retail prices of petroleum products?

2. Is the structure of the-Kenya oil market competitive enough to guarantee that the retail prices of petroleum and its products are determined in accordance with the existing petroleum market forces?

3. Should the retail prices of petroleum products be controlled or should competition be encouraged in the petroleum sub-sector?

4. Is the current legal framework sufficient to facilitate the regulation of the pricing of petroleum products?

5. To what extent do the operations of the international petroleum market impact any local market?

1.8 Research Methodology

In writing this dissertation, the researcher intends to employ both primary and secondary data, although the researcher presumes that the bulk of the research will derive from secondary data.

The secondary data the researcher intends to use will derive from predominantly from publications of eminent scholars on the relevant field. The researcher will also consult policy documents and other reports touching on issues pertinent to this dissertation.

Given the dynamic nature of the area of research, the internet is indispensable as a source of information in, the writing of this dissertation. The researcher will also rely on newspaper articles, journals and various other publications.

To measure the degree of market competition and concentration in the Kenyan petroleum industry, the researcher uses the Herfindahl Hirschman Index (HHI). The HHI is calculated by summing up the square of the market share of all companies in the market. The higher the index, the less competition exists in the market.

1.9 Scope of the Research

The purview of this study will be limited to the pricing of petroleum and petroleum products, and all other issues necessarily relevant there to. The research will not be limited to Kenya. Though by its very nature, the research necessitates perusal into certain aspects of the international petroleum industry and also to other jurisdictions, especially non-oil producing countries and how they maintain their oil prices. This will be done, albeit only to the extent that the particular aspect being interrogated has an influence on any local industry.

The research will not be constrained with regard to time. History will be consulted where necessary.

1.10 Hypothesis

It is the researcher's intention that the retail price of petroleum and petroleum products should be fixed by law.

1.12 Literature Review

The empire of the pricing of petroleum and petroleum products is widely traversed. In the past decade, the Kenyan petroleum sector has undergone rapid institutional and policy changes.[9] In light with these reforms, is the shift from strict government control to a liberalized market, with government involvement at a bare minimum.[10]

These changes have had far reaching implications on the oil industry, particularly with regard to access and affordability of petroleum and its products.[11] Although the public sector has retained a strong presence in the storage and refining of petroleum products. The pricing and marketing of oil is in the hands of the private sector, which comprises largely of the subsidiaries of multinational corporations[12]

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[9] Seewww.nockenya.co.ke/content.asp(last accessed on 15 March 2011)

[10] Ibid,

[11] http://africanewsonline.blogspot.com/2009/01/politics-of-oil-kenyas-economy.html(last accessed on 30 April 2011)

[12] See<www.kprl.co.ke/profile.html> (last accessed on 20 March 2011)

In their extensive study, published in the book[13] Patrick Nyoike and Benjamin Okech examined the key factors that affect the pricing of petroleum products within the framework of the liberalized regime.

The book posits that the retail price of petroleum and its products is made up of four main cost groups, namely procurement, refining and storage, inland delivery, profit margin and government taxes. Nyoike and Okech contend that of the four maid cost groups aforementioned, it is the government taxes and the private sector's pre-tax profit margins that profoundly influence the prices of petroleum. The retail pump prices of petroleum and its products reflect the high government taxes and levies imposed on petroleum products. It is posited that government taxation makes up nearly half of the retail price of most petroleum products.

This proposition is reiterated by **Ken Ikiara**[14] and **George Njenga**[15] in their article,[16] The discourse of the bulletin is, inter alia, the influence of Kenya's taxation structure on the retail price of petroleum and petroleum products. It is asserted that petroleum fuels are heavily taxed and that this is eventually reflected in the retail pump prices of these products. The bulletin lists the various taxes and levies imposed on petroleum and petroleum products and the percentages of the retail prices that these taxes and levies account for.

Of more import to the researcher, however, is the case made by the bulletin against the policy of differential taxation and cross-subsidization adopted by the government of Kenya. In the short term, it is posited, this policy may be applicable only as a temporary and populist measure but it is not effective in boosting the incomes of the indigent households because the real problem is that of low incomes.

Differential taxation, it is argued, has a very low probability of success as a policy objective. Given that the highest percentage of petroleum products in Kenya's used in the transport sector,

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[13] Petroleum Marketing in Africa: issues in Pricing and Taxation

[14] Mr. Ken Ikiara is a representative of the Petroleum institute of east Africa.

[15] Mr. George Njenga is a representative of Caltex Oil Company Limited

[16] Bulletin of the institute of economic Affairs, Issue No. 40 (November 2000)

the low income group, who are the expected beneficiaries of differential taxation and cross-subsidization, still end up paying the price of the higher taxation when they travel.

The researcher will pursue this line in chapter 1 of the dissertation.

Instructive, also, on the high prices of petroleum and petroleum products that the Kenyan consumers have to contend with, is the lack of competition in the petroleum sub-sector.[17] With the liberalization of the industry, the anticipated end was that the oil companies would adhere to the tenets of free market competition in arriving at the prices they charge for petroleum and petroleum products.[18] Government involvement was reduced to ensuring that competition was maintained in the industry.[19]

The government has however failed to make certain that the petroleum industry is competitive, contend Nyoike and Okech. Statistics show that only about eight (8) major oil companies, out of a possible pool of over fifty (50) companies, own all the filling and serving stations and control the marketing of petroleum products in the country.[20] In addition to this, the largest three (3) of the eight (8) companies control over 50 per cent of the market share.[21] This Nyoike and Okech posit is indicative of an oligopolistic market structure.

Further to this, they have used the Herfindahl Hirsman hidex (HHI) in the book to measure the degree of market competition and concentration in the petroleum industry. The HHI is calculated

[17] Ibid, Bhagavan

[18] Ibid,

[19] Ibid,

[20] Seehttp://africanewsonline.blogspot.com/2009/01/politics-of-oil-in-kenyas-economy.html(last accessed on 30 January 2011)

[21]Ibid

by summing up the square of the market share of all companies in the market.[22] The higher the index, the less competition exists in the market.[23]

At the time of the study, the HH1 in the Kenyan oil market was over 1,780 and 1,720 in 1994 and 1995 respectively.[24] This is evidentiary support of the proposition that the Kenyan oil market is oligopolistic in nature.

Peter M. Njoroge, in his report[25] makes a similar proposition as Nyoike and Okech. The report, which is an overview of the Kenyan petroleum sub-sector, analyses the structure of the oil market in Kenya deduces the level of competition in the market.

Peter Njoroge asserts that the Kenyan oil market is oligopolistic in nature. The oil majors heavily dominate practically every segment of the market. Using two methods of measuring market concentration, i.e. the Herfindahl Hirsman Index (Hll) and the Concentration Rate (CR). The extent of market concentration in this sector was assessed.

The Concentration Ratio is a way of measuring the concentration of market share held by particular suppliers in a market.[26] It is the percentage of total market sales accounted for by a given number of leading firms[27] thus; a four-firm Concentration Ratio is the total market shares the four firms with the largest market shares.[28] This particular statistic is sometimes referred to as the CR5.[29]

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[22] Seehttp://www.usdoj.gove/atr/public/testmony/hhi.html (last accessed on 30 January 2011)

[23] A virtual monopoly has a HHI of 10,000 which is equivalent to a 100 percent market share. A HHI of above 1,000 indicates a highly concentrated market which cannot sustain perfect competition while a HHI of 1,000 and below indicate a competitive market.

[24] Ibid, Bhagavan

[25] Competition at National and International Levels: Energy

[26] Intergovernmental group of experts on Competition Law and Policy, Geneva, Peter M Njoroge, Competition at National and International Levels: Energy (17-19 July 2007)

[27] Ibid

[28] Ibid

[29] Ibid

With regard to the HHI, the HHI in the Kenyan oil market was found to be 1650.58, 2342158, 1470.S, and 1591.02 in the yea 2002, 2003. 2004 and 2005 respectively.[30] This trend suggests a strengthening of the existing oligopoly.

This trend also observed in the Concentration Ratio of the four dominant companies.[31] According to statistics, CR5 declined from 86 in 2002 to 79.37 in 2003 and subsequently rose to 83.15 and 85.3 tin 2004 and 2005.[32] This provides further evidence of the tightening of the oligopoly in the Kenyan oil market.

Thus, using both indicators, the data shows that the wholesale and retail market segments of the petroleum industry in are an oligopoly in which the largest five companies control the market.

Patrick Nyoike and Benjamin Okech argue that the government has neglected its price-monitoring role. They assert that in the oligopolistic situation that has emerged in the petroleum marketing environment, the oil companies follow the restrictive trade practice of price leadership.[33] This practice involves one of the firms in a dominant position in the market taking a lead in determining and announcing price changes, with the firms with lower market shares simply following the pricing changes prompted by the dominant[34]

Nyoike and Okech further argue that the practice of price leadership vitiates the founding tenets of price liberalization, which states that imposed prices, irrespective of who does the imposing, are not in the long-term interest of the economy.

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[30] Ibid

[31] The concentration ratio shows the percentage of total sales in an industry made by the largest firms in that industry. Using this method, if the CR5=0, then perfect competition exists. If the CR5 is greater than 0, but less than 40, then effective competition or monopolistic competition is existent in the market. Where the CR5 is greater than 40, but less than 60, then the market is either a loose oligopoly or monopoly. Where, however, the CR5 is greater than 60, but les than 90, this is indicative of a tight oligopoly or a dominant firm with a competitive fringe. If the CR5 is greater than 90, then it shows either an effective monopoly or dominant firm with a competitive fringe.

[32] Ibid, Note 19

[33] Ibid, Bhagavan

[34] See www.digg.com/business/finance.htm (Last accessed on 30 January 2011)

This notwithstanding, the government has been unable to guarantee that the retail prices petroleum are determined in accordance with the existing petroleum market forces thus, curb the practice of price leadership. This is on account of the fact that the current legal framework is deficient

Curtailing restrictive trade practices is the purview of the RTPA[35]. Under the Act, the government is vested with the mandate to encourage competition in the entire economy by prohibiting practices that are in restraint of trade.[36]' The Act is, however, fundamentally deficient in preventing restrictive trade practices in the petroleum industry because of various shortcomings inherent in the Act.

Owing to the deficiencies, which deficiencies shall be interrogated at a later stage, the oligopolistic nature of the Kenyan petroleum industry is maintained, despite the adverse exploitative effects this market structure has on the citizenry.

The existence of both fiscal and non-fiscal barriers to the entry of new entrepreneurs into the petroleum industry also perpetrates the oligopolistic structure of our petroleum sub-sector[37] Nyoike and Okech identify a number of restraints to free market entry, albeit to be discussed later. They emphasize the need for the mobilization of new investment for the expansion of the marketing and retailing infrastructure in order to increase competition.[38]

Timothy Ranja, in his article, [39] pursues this line of thought further. He expansively examines the petroleum sector and economic development in East Africa. He discusses the refining process, importation and marketing, transport and distribution and the retailing of petroleum and petroleum products in Kenya, Uganda and Tanzania.

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[35] Chapter 504 of the Laws of Kenya

[36] Trade practices deemed, by la, to be restrictive are enumerated at Sections 6-12 of the Act

[37] Ibid, Bhagavan

[38] Ibid

[39] Ten Years After Liberating Petroleum Marketing £11 East Africa: Is the Playing Field Still Tilted Against the National Entrepreneurs?

Of particular import to this researcher is the article's assertion that State enterprises in the petroleum marketing and retailing in East Africa have not had any impact in the market. The National Oil Corporation of Kenya, opines the article, has not made any substantial investment to match the standards of the multinational oil companies. Referenced is the situation in Uganda where the government has already divested its interests in all the oil companies. This line of thought is welcomed by the researcher and shall be pursued further.

The researcher while greatly indebted to the immense wealth of knowledge and insight offered by Nyoike and Okech, insist also that the price selling mechanisms espoused therein may soon be rendered obsolete by the proposed regulations in respect of the retail pump price of petroleum products published by the ERC.

1.13 Chapter Breakdown

The final report will comprise of five (5) chapters. The content of the report is summarized as stated below:

Chapter One

This chapter will serve as an introduction to the dissertation and, in particular, the specific research topic chosen by the researcher. Herein will be the researcher's background of the study, objectives for conducting the study and the justification for the study. Also included here is legal theory used by the researcher in support of his arguments and a literature review of the books on whose insight he has relied on.

Chapter Two

Contained herein will be a dissection of all factors deemed to affect the retail prices of petroleum products. This will include both determinants that arise externally and internally.

Chapter Three

Here, the researcher intends to explore further the issue of competition, or the lack thereof in the petroleum sub-sector. Examined expansively will be the structure of Kenya's oil market and, further, the dynamics that dictate the structure of the market.

Chapter Four

An appraisal of the current regulatory framework and the proposed regulations published by the Energy Regulatory Commission establishing a formula for determining the maximum retail pump price of petroleum products which a person carrying on petroleum business shall sell at a retail dispensing site will be done in this chapter.

Chapter Five,

This chapter will be reserved for the conclusions and recommendations made by the researcher.

CHAPTER TWO

THE PRICING OF PETROLEUM AND PETROLEUM PRODUCTS IN KENYA'S PETROLEUM SUB-SECTOR

2.1 Introduction

Over the last twenty years, oil has become the biggest commodity market in the world.[40] In addition to being the largest commodity market in the global economy; oil is also the most complicated[41]. The physical international oil market trades many different types of crude oil and refined products, and the relative values of each grade are continually shifting in response to changes in supply and demand on both a global and a local scale.[42]

The driving force behind the rapid growth in oil trading is the huge variability in the prices of oil.[43] Indeed, daily price movements of US$1 per barrel are not uncommon and prices frequently change by up to 50 cents per barrel.[44] Since there is no obvious, upper or lower bound to oil prices, the value of a barrel of oil can double or halve within the span of a few months.[45]

As stated in the previous chapter, petroleum is Kenya's major source of commercial energy and has, over the years, accounted for about 67% of the country's commercial energy requirements.'[46] Consequently, the overall petroleum policy and Kenya is to ensure a secure, reliable and least-cost supply of petroleum and petroleum products of the domestic economy Consistent with this policy and in tandem with reforms in other sectors of the economy[47], the

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[40] Ingmar Mattus, application of derivative instrument in hedging of crude oil price risks, bachelor thesis

[41] ibid

[42] ibid

[43] ibid

[44] See<hhtp://www.nrean.ge.ca/eneene/sources/petpet/index-eng.php> (last accessed on 8 September 2009)

[45] ibid

[46] See http://ww.businessdailyafrica.com/opinion%20&%20analysis/index.xml > (last accessed on 22 august 2011)

[47] Session paper no.4 of 2004

government continues in its pursuit of the provision of petroleum and petroleum products at prices that are affordable to the common man.

Price is a signal from the market.[48] It is the equalizer that ensures supply always meets demand.[49] If demand exceeds supply, prices will rise until either new supplies are attracted to the market or the demand is dampened so that equilibrium is achieved.[50] If supply exceeds demand, prices will drop until the market is in balance.[51]

Owing to the researcher's prominence of the price of oil in the security and reliability of the supply energy in Kenya, finds it pertinent to analyze the pricing mechanism adopted in Kenya's petroleum market. Therefore, in this chapter, the researcher's embarks on an appraisal of the pricing policy employed. Incidental to this will be a dissection of all factors deemed to effect the supply and pricing of petroleum and petroleum products. Review of these costs is aimed at making sure that the consumer only pays prudently incurred costs, hence pair retail prices.

2.2 The Kenyan Petroleum Sub-sector in Context

The Kenyan petroleum sub-sector has not always been the free market that it is now; a market operating wholly on the basis of sound commercial principles and without the interference of the government, save for the minimal function of maintaining the legal system[52]' Prior to October 1994, the government actively regulated the oil industry, with very little involvement by the private sector.[53] This regulation entailed the government's involvement in the procurement, distribution and pricing of petroleum and petroleum products in the country.[54]

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[48] See<http://www.gasandoil.com/goc/marketintelligence/picoenergy/east.frica country report.htm> (last accessed on 5th March 2011)

[49] ibid

[50] ibid

[51] ibid

[52] Bhagavan, MR (1999) petroleum marketing in Africa: issues in pricing. Taxation and investments. page

[53] Ibid , Bhagavan page 41

[54] ibid

Hitherto the liberalization of the sector the importation of refined petroleum was subject to government approval. The National Oil Corporation of Kenya (NOCK) supplied 30% of Kenya s crude oil import quota.[55] Further the government in consultation with the various oil companies set the retail prices for petroleum products in the country. A cost plus pricing mechanism was used. This required that the maximum product prices are calculated from oil product import costs operating costs and allowable industry margins.[56]

However, since 27 October 1994, the procurement, distribution and pricing of petroleum products were liberalized with a view to enhancing the efficiency of the industry particularly with regard to supply and distribution.[57] Deregulation also sought to attract private capital through encouraging market competition[58]. The government retained only the responsibility of ensuring the security of supply of petroleum products.[59]

The effect of the liberalization has been profound and it has contributed immense changes not only in the manner of importation of petroleum but also in the supply and pricing of petroleum and its products and to the nature of regulation of the sector.

2.3 The Supply of Petroleum in Kenya

The system of importation of petroleum applied in Kenya is the OTS which is coordinated by the Ministry of Energy.[60] The OTS is a system under which, periodically, the Ministry of Energy invites tenders for the importation of specified quantities of both crude oil and refined products from the market [61] The company winning the tender imports the required quantity for the period

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[55] Seewww.nockenya.co.ke/content.asp > (last accessed on 5th March 2011)

[56] ibid

[57] Ibid, note 5

[58] ibid

[59] ibid

[60] See < www.allafrica.com/content.html > www.nockenya.co.ke/content.asp > (last accessed on 5th March 2011)

[61] ibid

and then the imported crude oil is sold to the various oil companies in proportion to their in the market[62]

Under the liberalized regime, the NOCK 30% crude oil supply quota was abolished.[63] Oil companies now have the liberty to import oil either in crude or refined form Presently Kenya meets her demand for petroleum through the importation of crude oil and the refining of the same at the Kenya Petroleum Refineries Limited (KPRL) at Mombasa and also through the importation of refined products.[64]

The OTS is regulated by the Petroleum Rules set out under the Petroleum Act, [65] and the tender terms and conditions for the delivery of crude oil into Kenya. Under section 31A of the Petroleum Rules, it is stated that no person shall import or cause to be imported petroleum crude oil for refining and use in Kenya, other than through an Open Tender System centrally coordinated by the Ministry Of Energy

Additionally all the licensed importers of petroleum products are required by law to participate in the importation of crude oil under the OTS Through this arrangement the Government is able to regulate the supply of petroleum[66].

2.4 Factors that Affect the Supply and Retail Price of Petroleum

2.4.5 Government Taxes

As mentioned earlier, inherent in the retail prices of petroleum and its products are the domestic variables[67], which variables include government taxes.[68] These taxes and levies profoundly influence the prices of petroleum products

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[62] ibid

[63] Ibid, note 5

[64] See <www.kprl.co.ke/profile.html> (12th March 2011)

[65] Legal Notice No. 197 of 2003

[66] Legal Notice No. 197 of 2 December 2003

Kenya's petroleum taxation policy lays emphasis on the generation of maximum revenues from the petroleum sector.[69] To illustrate this, reference may be made to the fiscal years of 1993/4 and 1994/5 where the revenue generated from the taxation of petroleum fuels accounted for 11.3 per cent and 12.6% of current revenues.[70] Over the years, the government has consistently derived more than 10 % of its revenue from the taxation of petroleum products.[71]

The taxes and levies imposed on petroleum and petroleum products in Kenya are listed thus:[72]

1. Import duty - This is levied on all products pursuant to the Customs and Excise Act.'63[73] Import duty is collected by the Commissioner for Customs and Excise.

2. Excise duty — This was introduced by the Minister of Finance in 1996 upon the abolition of Value Added Tax (VAT). The premise for the replacement of VAT with Excise Duly is that the Customs and Excise Act unlike the VAT Act does not allow business consumers of both petrol and automotive diesel to claim or offset the duty levied. Resultant is that the government is able to increase its revenue without raising the unit taxes for the aforementioned products.

3. Levies on petroleum fuels — The levies imposed on petroleum fuels are the PDL and RML. These were introduced through the 1994 Finance Bill and the 1991 PDL Fund Act respectively. The objective RML is to raise hinds for the maintenance of Kenya's road network. The objective of the PDL is to increase or supplement distribution and retail facilities m areas not adequately sewed by the existing oil marketing companies

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[67] Ibid, note 38

[68] Ibid, Bhagavan page 54

[69] Ibid, Bhagavan page 59

[70] ibid

[71] Bulletin of the institute economic affairs: petroleum industry since liberalization, issue no. 41 November 2000

[72] Ibid, Bhagavan page 54

[73] Chapter 472 of the laws of Kenya.

4. Transportation or bridging tariffs — These are levied on the products and vary according to the distance of the respective product distribution or marketing centre's from Mombasa and the mode of transport used.

5. Levy on Jet-A fuel — This is factored m as land rent for fuel storage facilities at Jomo Kenyatta International Airport and Moi International Airport

6. Town delivery tariffs — This is levied on road tankers to cover the cost of transport of products from wholesale depots to petrol stations in Nairobi and other towns.

2.4.6 The Implication of Taxation on the Pricing Mechanism of Petroleum

Under Sessional Paper on African Socialism and Its Application To Planning in Kenya[74], the government had signified its intention to keep the rate of tax to the Gross National Product at below 18% However, due to difficulties in its fiscal policies, the government was compelled to increase the ratio to 25% vide the Sessional Paper on Economic Management for Renewed Growth.[75]

The overriding concern of the government in levying taxation of petroleum products has been targeted at the maximization of revenue. Consequently, retail pump prices of petroleum and its products reflect the high government taxes and levies imposed on petroleum products. It is posited that government taxation makes up nearly half of the retail price of most petroleum products.[76] Indeed, for every litre of petrol sold, the Treasury picks up at least Ksh.30 as taxes[77]

It is my opinion that the heavy taxation of petroleum products by the government profoundly affects the retail price of these products. This is because the oil marketers pass on the taxes and

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[74] Sessional Paper No. 10 of 1965

[75] Sessional Paper No. 1 of 1986

[76] Ibid, Bhagavan Page 59

[77] See http://africanewsonline.blogspot.com/2009/01/politics-of-oil-in-kenyas-economy.html (Last accessed on 14th March 2011)

statutory levies imposed on them to the consumers at both the wholesale and retail levels and this is reflected in the price that the end-user has to pay for any petroleum products.[78]

This policy objective thus works against the government's responsibility to protect the interests of consumers in the petroleum sub-sector.

Another policy objective that the government has failed to achieve with regard to the taxation of petroleum products is it's aspiration to effect equitable income distribution in Kenya This seems to be the silver lining, the government's only redeeming quality, amidst the quandary that is our petroleum industry.

In conformity with this objective, the government of Kenya has adopted a differential tax regime.[79] Within this framework; the lowest rates of taxation are applied to kerosene used by low income households as lighting and cooking fuel.[80] The rates rise somewhat for Liquefied Petroleum Gas (LPG) which is used as cooking fuel by higher-income groups. The rates then rise substantially for other petroleum products.[81] Necessarily, cross subsidization emerges in the petroleum product market in Kenya.[82]

Cross subsidization refers to a market situation where one group in the market pays a relatively high price, thus enabling another group to pay a relatively low price.[83] Inevitably, certain products are sold above their economic values, while others are sold at prices lower than their values.[84] This variation in price arises not out of difference in product quality or costs. Rather, the government of Kenya has deliberately adopted discriminatory taxation and pricing policies designed to effect equitable income distribution.

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[78] Ibid, Bhagavan Page 56

[79] Ibid, Bhagavan Page 59

[80] Ibid,

[81] Ibid,

[82] Ibid,

[83] Ibid, Bhagavan Page 67

[84] Ibid,

It is with regard to equity concerns that these policies of differential taxation and cross subsidization have been adopted by the government of Kenya, even in the face of a liberalized market founded on the tenets of free market competition. Unfortunately, the levels at which taxation rates are pitched are so high that they do not allow the low- income earners to enjoy this affirmative action.[85]

Differential taxation can be thither vilified on the basis that it has occasioned the unanticipated rise of the adulteration of petroleum products.[86] The sale and distribution of petroleum products that do not meet regulatory standards is a perennial problem facing the oil industry.[87] This results in an unfair competitive advantage to those practicing this trade, which can be damaging to both the consumers and the industry in general.

With the entry of new and smaller players into the market, the adulteration of petroleum products has progressively been on the increase.[88] This is attributable to the fact that these new entrepreneurs, having to compete against the wider reach of the conventional stations, and in light of the taxation structure that makes kerosene cheaper than the other fuels, resort to buying minimal quantities of the petrol fuels and mixing them with kerosene to add to their margins.[89] Through such unscrupulous behaviour, they have been able to undercut the bigger companies by appearing to reduce their margins.[90]

2.5 Conclusion

It is patent that the oil market is as highly complicated as it is dynamic. Against this backdrop, the government has the responsibility to ensure security in the supply of energy to Kenyans and

[85] Ibid, The Point, Bulletin of Economics

[86] Ibid,

[87] See http://www.kenolkobil.com/home (Last accessed on 14th March 2011)

[88] Ibid, The Point, Bulletin of Economics

[89] Ibid,

[90] Ibid,

to ensure that the energy is so provided at the least cost possible. This vision is reiterated in the Energy Policy of 2OO4 [91]which aspires to lay a policy framework upon which quality, cost-effective, affordable and adequate energy supply to meet the development needs of this country can be made available to the domestic economy on a sustainable basis.

To this end, the ERC established under Sec. 4 of the Energy Act[92], was instituted as the regulator of the Kenya energy sector. It is tasked, *inter alia,* with the duty to regulate the importation exportation, transportation, refining, storage and sale of petroleum and petroleum products.[93] It is on this basis, and in tandem with its obligation to protect the interests of consumer, investor and other stakeholder interests[94] that the ERC published the proposed regulations in respect of the retail pump price of petroleum products.[95]

The regulations propose a formula for pump prices which incorporates all the price components discussed above. The formula derives from the four cost groups discussed, albeit with a few amendments to the formula outlined above.

However, what stands out with regard to the proposed regulations and the current pricing mechanism as outlined above is the effect of the import cost element on the retail price of petroleum in Kenya. The researcher submits that the import cost element affects the retail price of petroleum to a great extent. Accordingly, he opines that the government needs to give due consideration to this element and take a pragmatic approach to the regulation of this element given its vulnerability to the dynamics of the international oil market with the objective of ensuring that only costs prudently incurred by the oil companies are passed on to the consumers.

The researcher finds that the OTS system employed in Kenya for the procurement of petroleum is in tandem with the objects of the Energy Policy. The OTS was initiated by the Ministry of Energy as a means to streamline and regulate the importation of crude oil and refined petroleum

[91] Sessional Paper No. 4 of 2004

[92] Act No.12 of 2002

[93] Sec.5 (a)(ii)

[94] Sec.5 (b)

[95] The Petroleum Price Regulations, 2009

products into the country. It was intended to create an orderly market place with a view to reducing energy costs to Kenya through the economies of scale.

The OTS guarantees protection of the supply of petroleum.[96] It also ensures that petroleum is imported at the lowest bid price and that the price is not subjected to the fluctuating international market prices.[97] Thus, the OTS has been instrumental in stabilizing the retail prices of petroleum products. It also helps the government police the oil companies to ensure that only prudently incurred costs are paid by the consumer However; the OTS can be reformed their to increase its utility.

Further, the researcher finds the current tax regime oppressive to the players in the oil industry. The Kenya Revenue Authority, the institution charged with the responsibility of; inter alia, collection of taxes in Kenya, published vide Legal Notice No. of 2005 [98]regulations to the effect that excise duty on oil products shall become due and payable at the time of importation or time of release by customs from KPRL This effectively means that oil companies must pay their taxes up front.

The highly capital intensive nature of the Kenya petroleum industry is a well-known fact. The obligation to pay excise duty on oil products at the time of importation or time of release by customs from KPRL greatly increases the working capital requirements for the players in the oil industry.

It is the researcher's opinion that these regulations are a barrier to the entry of new players into the market as they make the financial costs required to enter the oil market extremely high. Consequently, interested persons are daunted by the capital intensive nature of the venture. This, in turn is detrimental to effective and fair competition in the industry. In the face of such regulations, it is difficult to envisage how the government can accomplish its vision as espoused m the National Energy Policy to avail quality cost effective, affordable and adequate energy supply to meet the development needs of this county on a sustainable basi

[96] Katisya-Njoroge, Caroline; Oil and Gas: The Challenge of Protectionism in Kenya

[97] Ibid

[98] Legal Notice No. of 2005

CHAPTER THREE

AN APPRAISAL OF CURRENT COMPETITION LAW AND POLICY

3.1 Introduction

As reiterated, energy occupies a pivotal position in any country's quest for economic deve1opment.[99] The availability of reliable supply of energy spurs economic development through raised levels of productivity, creation of employment opportunities and income generation. It is indispensable to dint out that one of the key sources of energy in Kenya is petroleum and petroleum products.[100]

Petroleum has, over the years, accounted for approximately 67% of the country's industrial and commercial energy requirements.[101] The major consumers of petroleum fuels include the transport, agriculture and manufacturing industries.[102] The consumption of petroleum fuels by these sectors rose by an average of 7% annually from 1.82 million tonnes in 2002 to 239 million tonnes in 2OO6.[103]

Petroleum remains without substitute as the only source of energy for the transport industry. Presently, petroleum accounts for approximately 22% of the national energy consumption.' [104]Further, over 76.4% of the Kenyan population relies on paraffin, a by product of petroleum,

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[99] See www.erc.go.ke (Last accessed on 26th March 2011)

[100] ibid

[101] Bhagavan, MR (1999) Petroleum Marketing in Africa: Issues in Pricing, Taxation and Investment, Page 24

[102] See http://www.paperblog.fr/finances (last accessed on 26th March 2011)

[103] Ibid

[104] Ibid, Bhagavan Page 23

kit Lighting.[105] Statistics indicates that the National consumption of kerosene in the year 2007 was 270,000 tonnes.[106]

In light of these facts, many legal and regulatory concerns come to the fore. Paramount is the security of the supply of energy to the Kenyan consumers. The cost of energy determines many, if not all, aspects of life. It is therefore important that this essential ingredient of any nation's life be secure. Key to the government's policy with regard to petro1eum is the assurance of secure, reliable and least-cost supply of petroleum product 'to the domestic economy, which objective is reiterated in the National Energy Policy of 2004. [107]

Consistent with this policy and in tandem with reforms in other sectors of the economy, the government liberalized the petroleum sub-sector in October 1994, thus adopting the 'free market' approach.[108]

The free market economic system operates on the basis of voluntary exchange as opposed to planning or control by a central authority.[109] In the market economy, decisions and the pricing of goods and services are guided solely by the aggregate interactions of a country's citizens and businesses with minimal government intervention.[110]

In adopting this perspective, the government's anticipation was to increase efficiency and security in the supply and distribution of petroleum products in Kenya?[111] Thus, with the liberalization of the petroleum industry, the pricing and marketing of petroleum and petroleum products was vested wholly in the hands of the private sector.[112]

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[105] The Kenya Integrated Household Budget Survey of 2005/06

[106] Ibid

[107] Sessional Paper No. 4 of 2004

[108] Ibid, Bhagavan Page 4

[109] See http://en.wikipedia.org (Last accessed on 26th March 2011)

[110] Ibid

[111] Ibid, Bhagavan Page 4

[112] Ibid

Unfortunately however, it is clear that the government has been unable to achieve this objective This proposition rings true and relevant in view of the fact that the local petroleum market has, in the recent year, been beleaguered by dramatic increases in the retail prices of petroleum and petroleum products[113] Even after a dramatic fall in global .oil prices, with the prices falling by as much as 50%, there was little change in the retail prices in the local market.[114]

It is the researcher's contention that Kenya's free-market economy stance has shown that it cannot realistically protect the interests of consumers. An examination of the petroleum subsector subsequent to its deregulation has shown that security and efficiency in the supply and distribution of petroleum and its products ha not yet been achieved Far from it.

It is on this premise that the researcher's undertakes to examine the level of competition in Kenya's petroleum sub-sector and the effect that this has on the retail prices of petroleum products.

3.2 The case for Competition Law

Competition policy may be defined as the entire set of government declarations that have the effect of determining the structure, operations and efficiency of markets in a country.[115] By natures therefore, competition policy is composed of the all policies that a government pursues that affect the market structure and the behavior of firms in various sectors of that economy.[116]

Necessarily, it follows that regulation must exist to govern the market place.[117] The government must intervene through its regulatory framework to ensure goods. Are availed to the citizens at a price that is within their reach Jeremy Bentham's theory of utilitarianism forms a proper

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[113] See www.bbc.co.uk/news/business.html (Last accessed on 26th March 2011)

[114] Ibid

[115] The Point, Bulletin of the Institute of Economic Affairs: Developing the Frontiers of Kenya's Competition Law and Policy, Issue No.45 May 2001

[116] Ibid

[117] Whish, R (2003) Competition Law, Butterworth & Co (Publishers) Ltd, London, Page 2

foundation from which this proposition can be made. Bentham argued that the law must seek to achieve the greatest good for the greatest number of people in society.[118]

The relevant piece of legislation with regard to- competition law and policy in Kenya is the RTPA.

The Energy Act [119]ERC, Section 4 thereof and gives it the mandate to regulate the Kenya energy sector. At Section 5 of the Act, the ERC is obligated to, *inter alia*, "monitor ensure implementation of, and the observance of the principles of fair competition in the energy section, in coordination with other statutory authorities"[120]

Since the liberalization of the petroleum industry, the Kenya oil market is founded on the tenets of free market competition operating wholly on the basis of sound commercial principles[121] With the liberalization of the industry, the anticipated end was that the companies would adhere to the tenets of free market competition in arriving at the prices they charge for petroleum and petroleum products[122]

However, the Kenya petroleum market is dominated by profit-driven almost monopolistic multinational companies who manipulate the Local market in their quest for maximization of profits. [123]These companies do not adhere to the principles of free market competition. Oil companies absolutely disregard Adam Smith's admonitions that all restraint on trade or on production for purposes of trade is an evil[124] Inherent in the market are practiced that are restrictive to trade and which deter competition in the market.[125]

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[118] Fuller, Lon L; The problems of Jurisprudence, 1949

[119] Act No. 12 of 2006

[120] Section 5(d)

[121] Ibid, Bhagavan Page 43

[122] Ibid,

[123] Ibid,

[124] Smith, A (1776) The Wealth of Nations, Chapter 10, Paragraphs 82

[125] Ibid,

This proposition is evidenced by the exorbitantly high prices that the Kenyan consumer are subjected to, the constant fluctuations in the retail prices of petroleum and petroleum products and the artificial shortages occasioned by the oil companies as a mode of manipulating the market.[126]

This scenario calls into play RTPA.[127] The RTPA, as espoused in its preamble, is an Act of Parliament to encourage competition in the economy by prohibiting restrictive trade practices, controlling monopolies, concentrations of economic power and prices and for connected purposes. The overall objective of the Act; therefore is to deal with the imperfections of the market.

3.3 Structure of the Kenya Petroleum industry market

Industrial organization is a field of economics that studies the strategic behavior of firms, the structure of markets and their interaction.[128] The theory is concerned with the workings of markets and industries, in particular the way firms compete with each other.[129] It emphasizes on firm strategies that are characteristic of market interactions such as price competition, product positioning advertising *inter alia*.[130]

The aspiration of industrial organization is 10 address the following four questions:[131]

1. Is there market power?
2. 2 How do firms acquire and maintain market power?

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[126] See http: www.africanewsonline.blogspot.com/2009/01/politics-of-oil-inkenyas-economy.html (Last accessed on 26th March 2011)

[127] Chapter 504 of the Laws of Kenya

[128] See http://www.wikipedia.org/wiki/Economics (Last accessed on 26th March 2011)

[129] Cabral. ML, Introduction to Industrial Organization

[130] Ibid

[131] Ibid

3. 3 What are the implications of market power?

4. Is there a role for public policy regarding market power?

The standard approach in industrial organization decomposes a market into structure, conduct and performance of the market.[132] The theory studies imperfect competitive markets, that is, those markets in which one or more firm exercise monopoly power or in which information is either unequally available or too complex to analyze as well as markets where a firm is able to exercise market power and set a price above marginal cost. [133]In general, such markets cannot be analyzed with the standard competitive model, hence the industrial organization theory.[134]

By applying microeconomics and game theory, the industrial economics organization theory examines the strategic interaction and behavior of firms to acquire and maintain market power, and use these theoretical tools to explain observed features in particular markets and industries, such as the determination of prices, product positioning, research and development, advertising *inter alia.*[135] Industrial organizations devotes considerable attention to exploring the definition of markets, market conduct, structure and performance, and the effects of exogenous, i.e, non-economic variables on them.[136]

The principal, though not exclusive, dimensions of market structure are listed as follows:[137]

i. The degree of concentration of buyers and sellers.

ii. The degree of product differentiation.

iii. Conditions of entry

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[132] Shy, O, Industrial Organization: Theory and Applications

[133] See http://www.amosweb.com (Last accessed on 26th March 2011)

[134] Ibid

[135] See http://www.highbeam.com (Last accessed on 26th March 2011)

[136] Ibid, Shy, O

[137] See http://www.westga.edu/-bquest/1997/ecnmkt.html (Last accessed on 26th March 2011)

The Kenyan petroleum sector is characterized by a number of barriers which tend to restrain free entry into the market, thereby sustaining the oligopolistic structure of the sector.[138]

These barriers may be listed as follows:

1. **High seed capital requirement**

It goes without saying that the petroleum business is highly capital-intensive. Indeed, it is posited that the start-up capital required for a prospective investor wishing to import an economic crude oil cargo and finished product, distribute and use the pipeline is approximately US $30 Million.[139] Further, it is estimated that an entrant into the retail market would need about Kshs 30-50 million to build a modest retail Outlet fin the main cities.[140]

This necessarily puts the new entrants at a. disadvantage. Therefore, this requirement for capital-intensive investment necessarily forms a formidable barrier to market entrants of Kenyan origin and particularly favours corporations with huge capital reserves and those who have high credibility in terms of credit standing.[141]

2. Vertical integration in the petroleum sub-sector

Vertical integration explains the process by which different stages in production and distribution of a product are under the ownership and control of a single enterprise.[142] This can be achieved internally by setting up retail outlets or by establishing subsidiary companies to which the task of

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[138] Ibid, Bhagavan Page 49

[139] Indetie, Livingstone; Emergency of Independent Petroleum Dealers in Kenya, Special Report No. 4/2003 IPAR Special Report Series.

[140] Ibid, Bhagavan Page 49

[141] Ibid, Bulletin of the Institute of Economics Affairs

[142] See http://tutor2u,net/economics/revision-notes/index.html (Last accessed on 29th March 2011)

distribution is entrusted[143]. Vertical integration is a barrier to entry because it could impede access for a would-be entrant to the market.

Vertical integration often gives incumbent undertakings a strategic advantage over new entrants. The ECJ in a case[144] held that the extent to which TJBC's activities were integrated provided the firm with commercial stability which was a significant advantage over its competitors. In[145] the ECJ pointed to Roche's highly developed sales network as a relevant factor conferring upon it commercial advantages over its rivals.

Vertical integration is apparent in the character of our local petroleum industry where the major oil companies usually dominate the procurement process, run a fleet of tankers, operate refineries and have control of sales at their own filling stations.[146]

3. Co-ownership of the Refinery

Although intermittent oil prospecting has been going on in Kenya, no commercially exploitable petroleum reserves have been found thus far. Kenya imports all the petroleum consumed chiefly from the Persian Gulf area Most of it is imported as crude oil before it is refined at the Kenya Petroleum Refineries Limited, hereinafter KPRL, in Mombasa and then transported inland by pipeline, road and rail.

KPRL is a limited liability company jointly owned by the Government of Kenya and the oil marketing companies The Government of Kenya is the majority shareholder in the company, owning 50% of the equity.[147] The Shell Petroleum Company Limited and BP each hold 17.1%, while Chevron Limited, trading as Caltex, holds 15.8% of the equity.[148]

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[143] Ibid, Whish Page 585

[144] *United Brands vs. Commission* (1978) 1 CMLR 429

[145] *Hoffman-La Roche vs. Commission* (1979) 3 CMLR 211

[146] Ibid, Bulletin of the institute of Economic Affairs

[147] See www. Kprl.co.ke/profile.html (Last accessed on 29th March 2011)

[148] Ibid

To that extent, therefore, the individual marketing firms have a business relationship with the government and one another as far as the profitability or efficiency of the refinery is concerned. This relationship may be a barrier to entry because new entrants who wish to make use of the facility would have to negotiate terms with real competitors in the market place.[149]

4. Lack of common-user track loading facilities and refusal by the new established companies to offer hospitality to the new entrants.

5. Livingstone Indetie, in his report titled 'Emergence of Independent Petroleum Dealers in Kenya propounds that since new entrants rely on the multinationals for their supplies, the possibility of price inversion is very real. This would occur in situations where the multinationals own outlets competing directly with independents. It is possible, therefore, to give their outlets more favourable prices than those offered to independents.

The issue of price inversion, argues Indetie, is aggravated because retail outlets are constructed too close to each other thus creating an atmosphere of negative competition between the independents and the multinationals fro whom they buy.

That deregulation brought in its wake new entrants to the oil industry is indispensable to note. The petroleum sub-sector has seen new players enter the market with a view to engage in import, export, wholesale and retail in the petroleum business. Successive to the liberalization of the oil industry, more than fifty (50) oil trading enterprises have been licensed to operate in the industry.[150]

Of profound disappointment is, despite this initiative, the impact of the new entrants in the industry has been almost insignificant.[151] Take, for instance, the scenario depicted in 1996 where the gross profit margins for petrol and diesel rose from US$0.31 and US$0.18 respectively, per

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[149] Ibid, Bulletin of the institute of Economic Affairs

[150] Timothy Ranja, Economic and Social Research Foundation: Globalization and East Africa, Working Paper Series No. 12

[151] Ibid, Timothy Ranja

American gallon, in February 1996 to US$0.36 and US$0.29 in October 1996.[152] This does not reflect the expected consumer price trends in a market with so many oil marketing firms.[153]

Further to this, only approximately ten (10) of the new entrants are actively trading in the petroleum sub-sector, albeit with a dismal market presence of less than 10% of the market share.[154] The market is dominated by the major oil companies, namely, Shell/BP, Caite4 Total/Elf, Mobil, Agip and Kenol-Kobil, which companies account for over 80% of the market share. Fuelex Oil, the largest local oil company, accounts for less than 1 per cent of the market share.[155]

3.4 Enumeration of Competition Law and Policy in Kenya

One of the facets of the industrial organization theory as discussed above is market conduct. This refers to the pattern of behavior that an undertaking follows in adopting or adjusting to the market in which it operates. Market conduct comprises the practices/policies pursued by undertakings, whether acting individually or collectively, in relation to the promotion of their price, products and/or sales and also in relation to competing firms.[156]

These policies and/or practices are adopted by undertakings in the market place as means of obtaining concentration of economic power[157] The practice may take the form of collusion or agreement, inter-dependence of pricing and related adjustments or the exercise of predatory or exclusionary trade practices directed against either established rivals or potential entrants.[158]

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[152] Ibid, Bhagavan Page 4

[153] Ibid,

[154] Ibid, Timothy Ranja

[155] Ibid,

[156] Ibid,

[157] Ibid,

[158] Ibid,

Most of these practices are conveniently labeled, in the language of the RTPA, restrictive trade practices. The Kenya law on restrictive trade practices is intended to cover a very wide area. It covers acts intended to reduce or eliminate the participation of legal and natural persons in economic activities It embraces trade agreements, trade associations, refusal and discrimination in supply, predatory trade practices, collusive tendering and collusive bidding at auction sales.

Prior to the enactment of the RTPA in 1988, the doctrine of restraint was the only tool available to tackle problems regarding monopolies and restrictive trade practices.[159] The doctrine of restraint of trade was a precursor to the RTPA. The tenets of this doctrine were enumerated in the Contracts in Restraint of Trade Act of 1932.[160] The concept of 'restraint of trade' is a difficult one to define. Yash Vyas posits that any brief definition of this concept falls short of the legal concept of restraint of trade while no broad definition can really unlock the meaning of the term.[161]

Lord Diplock in the case of *Petrofina*[162] defined a contract in restraint of trade as one in which a party (covenantor) agrees with any other party (the covenantee) to restrict his liberty in the future to carry on trade with other persons not parties to the contract in such manner as he chooses.

In the same case, Lord Denning stated thus with regard to contracts in restraint of trade:"...any contract which interferes with any member of the community's free exercise of his trade or business, by restricting him in the work he may do for others, or the arrangements which he may make with others is a contract in restraint of trade."

The English position with reference to contracts in restraint of trade was laid down by the House of Lords in the case of *Nordenfelt*[163] Lord Macnaghten, in his ruling, stated

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[159] Vyas, Tash, Anti-Competitive Trade Practices and the Law Relating to Contracts in Restraint of Trade: The Kenyan Perspective, University of Nairobi Law Journal Vol, 1 2003

[160] Chapter 24 of the Laws of Kenya

[161] Ibid, note 53

[162] *Petrofina (Gnat Britain) Ltd vs. Martin* (1966) Ch 146, at Page 180

[163] *Nordenfelt vs. Marlin Nordenfelt Guns & Ammunition Co* (1894) A.C 535

Thus; the Court in *Nordenfelt* established that all restraints of trade are void save where it can be shown that:[164]

a. The restraint is reasonable as between the parties to the agreement , that is, it goes no further than is necessary to protect one of the parties from the unreasonable competition of the other; and

b. The restraint is not unreasonably injurious to the public.

The Kenyan position differs somewhat from the English one. Enumerated at Section 2 of the Contracts in Restraint of Trade Act, it is as follows:

Any agreement or contract which contains a provision or covenant whereby a party thereto is restrained from exercising any lawful profession, trade, business or occupation shall not be void only on the ground that the provision or covenant is therein contained: Provided that –

(i) The High Court shall have power to declare the provision or covenant to be void where the court is satisfied that, having regard to the nature of the profession, trade, business or occupation concerned and the period of time and the area within which it is expressed to apply, and to all the circumstances of the case, the provision or covenant is not reasonable either in the interests of the parties; inasmuch as it affords more than adequate protection to the party in whose favour it is imposed against something against which he is entitled to be protect or in the interests of the public, in as much as the provision or covenant is injurious to the public interest.

Thus, under the Kenyan law, a contract in restraint of trade is prima facie valid, but the High Court has the power to declare it void if it can be shown that:

a. The restraint is not reasonable between the parties to the agreement

b. The restraint is not reasonable in the interests of the public, that is, it is injurious to the public interest.

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[164] Ibid, Note 40

The provisions of the Contracts in Restraint of Trade Act, whose preamble describes it as an Act of Parliament to make lawful certain contracts in restraint of trade, are now inculcated in the RTPA This Act contains systematic and extensive anti-monopoly provisions geared towards prohibiting restrictive trade practices and controlling monopolies, concentrations of economic power and price.

Section 4(1) of the RTPA provides the general definition of restrictive trade practice as follows:

For the purposes of this Act, "restrictive trade practice" refers to an act performed by one or more persons engaged in production or distribution of goods or services which:

(a) In respect of other persons offering the skills; motivation and minimum seed capital required in order to compete at fair market prices in any field of production or distribution, reduces or eliminates their opportunities so to participate; or

(b) In respect of other persons able and willing to pay fair market prices for goods or services, either for production, for resale or final consumption, reduces or eliminates their opportunities to acquire those goods or services.

There are various types of trade practices and these are enumerated at Sections 6-12 of the Act. These practices are so called because they restrict a person in his trade, business, profession or occupation and they have the overall effect of distorting competition.

Creating a competitive business environment is essential to the operational efficiency of the petroleum sector. The level of competition in Kenya's oil industry spells inefficiency and ineffectiveness. The industry is rife with various trade practices that are restrictive to trade.

3.5 Conclusion

It is evident that the structure of the Kenya oil market is not competitive enough to guarantee that the retail prices of petroleum and its products are determined in accordance with the existing petroleum market forces.

The RTPA has shown that it cannot properly contain, control or sanction the players in t the oil market. The Energy Act errs by failing to thither create an elaborate procedure through which the Energy Regulatory Commission can regulate prices in the oil industry, other than by making recommendations to the Minister in charge and coordinating with Commissioner for Monopolies and Prices.

CHAPTER FOUR

THE CURRENT REGULATORY FRAMEWORK OF THE RETAIL PRICES

4.1 Introduction

The link between economic growth and energy consumption has been well established:

Ample supplies of usable energy are essential for development.[165] As reiterated in previous chapters, energy security spurs economic development. It is pertinent, therefore, that the government takes measures through appropriate legal and regulatory frameworks, to ensure that energy security is guaranteed alongside our decidedly free market environment.

With the liberalization of the petroleum industry, which liberalization was aimed at the increase in efficiency and security in the supply and distribution of petroleum products in Kenya, the pricing and marketing of petroleum and petroleum products is a province now exclusive to the private sector.[166]

However, that the Kenya oil market is dominated by profit-driven, almost monopolistic, multinational companies who manipulate the local market in their quest for maximization of profits is well ascertained.[167] Whereas Kenya operates in a free market economic and business environment, the unregulated nature of the oil market affords the multinational oil companies in the country the opportunity to adopt cartel-like behavior[168] companies, which remain cushioned from the operations of the Restrictive Trade Practices, Monopolies & Price Control Act[169] owing

[165] See http://www.nockenya.co.ke (Last accessed on 23 April 2011)

[166] Bhagavan, MR (1999) Petroleum Marketing in Africa: Issues in Pricing, Taxation and Investment, Page 21

[167] See http://www.ipar.or.ke (Last accessed on 23 April 2011)

[168] See http://www.africannews.com (Last accessed on 23 April 2011)

[169] Chapter 504 of the Laws of Kenya

to the deficiencies intrinsic therein, do not observe the principles of free market competition and often unjustifiably hike the prices of petroleum products to supernormal levels.[170]

Indeed, the local petroleum market has, in the recent year, been beleaguered by dramatic increases in the retail prices of petroleum and petroleum products[171] This has been cited by the oil companies as a ripple effect of the situation in the international oil market where the price of crude oil hit an unparalleled high of US$139.12 per barrel in June 2008.[172]

However, the retail prices of petroleum products have not closely followed the changes in international oil prices[173] It has been argued variously that oil companies are quick to adjust retail petroleum prices upwards when international oil prices are rising and slow to lower prices when oil prices are falling.[174] This rings true and relevant in view of recent events where, the load port price of Murban crude oil plummeted from a high of US$ 139. 42 per barrel in June 2008 to USS 42.40 per barrel in December 2008, while the pump price of super petrol in the Kenya oil market dropped from Kshs. 110.00 per litre to Kshs.78.00 per litre over the same period.[175] This translates to a 69.74 per cent drop in the international oil market prices iris a iris a 29.09 per cent drop in the local market.

That the local retail market prices do not correspond to changes in the international oil market can be attributed to the avarice of the profit-driven multinational companies who swiftly pass on increased costs to consumers, but take inordinately long to pass on cost reduction benefits to consumers when international oil prices are on a downward spiral.[176] These trends have become altogether too familiar to the Kenyan citizens.

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[170] Ibid, Note 4

[171] See <http://sudanvisiondaily.com> (last accessed on 23 April 2011)

[172] See www.bbc.co.uk/news.business.html (Last Accessed on 30th April 20011)

[173] See http://www.erc.go.ke (Last Accessed on 30th April 2011)

[174] Ibid

[175] Ibid

[176] See http://blackpacker.gnn.tv(Last Accessed on 30th April 2011)

There is no doubt that an abundance of cheap energy spurs industrial development. The high fuel prices that the Kenyan consumers have had to contend with have been touted as an impediment to economic recovery, particularly subsequent to the post election violence that shook our country in December 2007.[177] From a projected high of in the order of 8% economic growth in 2007, Kenya's economy only managed a meager 4.8% industrial growth rate in 2OO8.[178] Further, the GDP growth rate decreased from 7% 2007 down to 2.2% in 2008.[179]

It is patent that uncertainty in energy security poses a threat to economic growth and has adverse effects on Kenyans, a large population of whom live below the poverty line. It is estimated that 39.9& of Kenyans live on less than US$ I per day.[180] That the high oil prices usually translate to a rise in the price of essential commodities, including food, is now well known to Kenyans. The high fuel prices drive up the cost of production, which hike the manufacturers pass on to the consumers. A survey by the Nation Media Group discovered that the prices of essential foodstuffs had risen by more than 50% in the first half of 2008.[181]

The outlook is gloomy for the common man who is feeling the effects of a double digit inflation of 26.3% and the rise in prices of basic consumer goods. Like an ice erg, only the tip of the totality of the pressures heaved upon the man is visible from the facts set out above; Energy security is pertinent in alleviating the plight of our people.

Without the patronage of appropriate legislation, the government is ill equipped to combat the constant price fluctuations and artificial shortages instigated by the players in the oil industry. That this situation subsists despite the free market economic stance adopted by the government is, to me, a clear indicator of the inadequacies of the existing legal and regulatory framework in the energy sector, it is my contention that our national petroleum policy lacks the ability to

[177] See http://www.africanews.com (Last Accessed on 25 April 2011)

[178] Ibid

[179] UNEP Report on Kenya: Integrated Assessment of the Energy Policy with Focus on the Transport and Household Energy Sectors

[180] See http://www.nationmedia.com/dailynation(Last Accessed on 25 April 2011)

[181] See http://ww.cia.gov/ke.html(Last Accessed on 25 April 2011)

stabilize the prices of petroleum products and also check on the arbitrary price fluctuations for purposes of the protection of the Kenyan consumers.

The citizenry needs to be cushioned from the constant price hikes and the artificial shortages prompted by the oil companies, all itinerary to their manipulation of the market. The government has a role to play in protecting the interests of the consumer, the investors and other stakeholder interests in our capitalist economy.

Thus, in this chapter, the researcher undertakes an appraisal of the current legal and regulatory mechanisms available for the purpose of stabilizing petroleum prices for purposes of protecting consumers and checking on arbitrary price fluctuations. An assessment of the proposed regulations published by the Energy Regulatory Commission establishing a formula for determining the maximum retail pump price of petroleum products which a person carrying on petroleum business shall sell at a retail dispensing site will also be done in this chapter.

4.2 The Energy Act

In carrying out its functions, the Ministry of Energy is guided by its vision which is thus: "to promote equitable access to quality energy services at least cost while protecting the environment."[182] This vision reiterates the spirit of the National Energy Policy as encapsulated in Sessional Paper No. 4 of 2004 on Energy which aspires to lay a policy framework upon which quality, cost-effective, affordable and adequate energy supply to meet the development needs of this country can be made available to the domestic economy on a sustainable basis.

In conformity with the National Energy Policy, the legislature enacted the Energy Act[183] as the piece of legislation responsible for the regulation of the energy sector in Kenya, thereby repealing the Petroleum Act[184] and the Electric Power Act.[185] The Energy Act, as stated in its

[182] See http://www.energy.go.ke(Last Accessed on 25 April 2011)

[183] Act No. 12 of 2006

[184] Chapter 116 of the Laws of Kenya

[185] Chapter 117 of the Laws of Kenya

preamble, is an Act of Parliament to amend and consolidate the law relating to; energy. It is a comprehensive legislation that encompasses the petroleum and natural g sub-sectors, the electrical energy and renewable energy sub-sectors. It seeks to regulate the various sub-sectors through, inter cilia, establishing licensing requirements, setting tariffs, creating terms and conditions for trade in the energy sector among a myriad other facets of regulation.

Petroleum is an important sources of energy for economies the world over. Over the last twenty years, oil has become the biggest commodity market in the -world.[186] Petroleum products are essential inputs needed in the transport, manufacturing, and agriculture and mining industries as well as in households. Petroleum is a key ingredient in all sectors of modern economies.

Petroleum finds use as Kenya's major source of commercial energy and has, over the years, accounted for approximately 67% of the country's industrial and commercial energy requirements.[187] Petroleum fuels find widespread use in all the productive sectors of the Kenyan economy and account for 22% of the national energy consumption.[188] They provide the agricultural sector with 9.2% of the energy needs, the manufacturing sector with 29.6%, while households account for less than 5% of the energy consumption of petroleum fuels.[189] The transport sector in Kenya is entirely powered by petroleum products; petroleum remains without substitute as the only source of energy for the industry.

It is well established that, aside from wood fuel which accounts for 68% of the Kenyan national energy consumption,[190] petroleum is the foremost source of energy. However, the fact that Kenya is not a producer of petroleum and is wholly dependant on imported crude oil and refined petroleum products chiefly from the Persian Gulf area puts her in a vulnerable position particularly with regard to security in the supply of petroleum. That the earth has a finite amount

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[186] Ingmar Mattus, Application of Derivative instruments in Hedging of Crude oil Price Risks, Bachelor Thesis

[187] Ibid, Bhagavan Page 24

[188] Ibid

[189] Bulletin of the Institute of Economic Affairs, Petroleum Sub-Sector: Debating the Appropriate Policy Framework, Issue No. 44 2001

[190] Ibid, Bhagavan Page 24

of hydrocarbon resources that are quickly depleting also affects the supply of petroleum[191] this is further compounded by the fact that petroleum products have no viable substitute in the foreseeable future and, as a consequence thereof, their demand inelastic, that is, changes in the price do not affect the consumption thereof.[192]

Faced with such circumstances, the government's need to regulate the sub-sector with the objective of guaranteeing energy security to the Kenyan citizenry and also to ensure that the interests of all stakeholders are well guarded is warranted. It is upon this foundation that the Petroleum Act was repealed and the Energy Act enacted.

The Act, which, pursuant to Section 3, is meant to apply to "every person or body of persons... importing, exporting, transporting, refining, storing and selling petroleum or petroleum products... and to all works or apparatus for any or all of these purposes", establishes, at Section 4 thereof, the Energy Regulatory Commission (hereinafter ERC), which is a body corporate capable of suing and being sued, owning and transacting in property, inter alia, as the energy sector regulator with the directive to facilitate and enhance delivery of sustainable, robust and quality energy services.[193]

Central to the functions and objects of the ERC is to regulate, inter alia, the importation, exportation, transportation, refining, storage and sale of petroleum and petroleum products. [194]Specific provisions with regard to these are set out at Part IV of the Act which deals with the issuance of business licenses for the importation, storage, refining, exportation, sale and resale and transportation of petroleum and natural gas. Also provided for are regulations on the issuance of permits for the consumption of refineries, pipelines, bulk storage facilities and retail dispensing sites. Issues relating to standards for petroleum products, equipment, facilities and installations, maintenance of minimum operational and strategic stocks are also dealt with in this

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[191] See http://www.theoildrum.com(Last Accessed on 25 April 2011)

[192] See http://www.proutjournal.org/economy.html(Last Accessed on 25 April 2011)

[193] See <http://www.erc.go.ke/mandate.htm>(Last Accessed on 25 April 2011)

[194] Section 5 (a)(ii)

Part. Penalties for offences relating to petroleum and natural gas undertakings are also prescribed herein.

Any person aggrieved by the Commission's decision may appeal to the Energy Tribunal which is established at Section 108 of the Act for the purpose of hearing and determining the appeals Further recourse to the High Court is provided for at Section 11(3) of the Third Schedule which allows any person aggrieved by the Tribunal's decision to appeal to the High Court within thirty (30) days from the date of the decision or order. Any person aggrieved by the decision of the High Court may, within thirty (30) days of the date of the decision, appeal to the Court of Appeal.[195]

In accordance with Section 10 (1) of Schedule 111, the Tribunal has the jurisdiction to hear and determine all matters referred to it relating to the Energy sector arising under the Act. However, its jurisdiction does not extend to the trial of any criminal offence or the hearing of any dispute that a licensee and any otter party may have agreed to settle in accordance with their agreement.[196]

On the issuance of licenses, Section 80 (1) of the Act provides that a person shall conduct a business of importation, exportation, wholesale, retail, storage or transportation of petroleum, except under and in accordance with the terms and conditions of a valid license. Further, a licensee shall not sell petroleum to a person for the purpose of exportation or for resale in Kenya unless that person has a valid exporters or retail license under the Act.[197]

Section 90 (1) of the Act requires any person intending to construct a pipeline, refinery, bulk storage facility or retail dispensing site to apply to the ERC in writing for a permit to do so before commencing such construction. Section 91 (1) provides a set of guidelines that the ERC should take into account before issuing a permit.

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[195] Section 11(6) of the Third Schedule of the Energy Act

[196] Section 10(2) of the Third Schedule of the Energy Act

[197] Section 80(2)

Part IV of the Act also deals with issues relating to standards for petroleum products, equipment, facilities and installations and provides that petroleum imported or produced locally for use in Kenya petroleum products, equipment, facilities and installations shall conform to the relevant Kenya Standard,[198] The provision thereto states that where no such standard exists, the relevant international standards approved by the Kenya Bureau of Standards shall apply. Thus, any person dealing with petroleum must ensure that the petroleum meets the standards set out by the Standards Act.

Section 96 of the Act obliges any person licensed to import petroleum to maintain such quantities of petroleum and at such locations as may be prescribed by the Minister of Energy in consultation with the ERC. The Minister has the power, pursuant to Section 97, to undertake in whole or in part, the provision of financing, procurement, maintenance and management of petroleum strategic stocks. Sections 100 and 101 enumerate various offences relating to petroleum and natural gas undertakings and the penalties thereto.

In exercise of the powers conferred by Sections 97 and 110 of the Act, the Minister for Energy made The Energy (Petroleum Strategic Stock) Regulations, 2008 in April 2008. Regulation 3 of the said Regulations sets out that there shall be maintained a stock of petroleum products to be known as the Petroleum Strategic Stock.

The Regulations set out that Strategic Stock shall be maintained in respect of premium motor spirit, illuminating kerosene, jet fuel (kerosene), automotive gasoil and liquefied petroleum gas at a level equivalent to up to ninety days of consumption of each of these products.[199]

The objectives of maintaining the Strategic Stock are set out as follows:

a. To provide a strategic reserve of petroleum products in the country;
b. To ensure continuity of supply of petroleum products in case of disruption of supply of the products; and
c. To stabilize domestic prices of petroleum products.

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[198] Section 95(1)

[199] Regulation 4 of the Energy (Petroleum Strategic Stock) Regulations, 2008

Regulation 5 provides that Strategic Stock shall be procured by the National Oil corporation of Kenya (NOCK) and stored by the Kenya Pipeline Company Limited, and, in case of consumption or draw down, shall be replenished accordingly to its optimal level.

In tandem with the National Energy Policy, the ERC is duty-bound at Section 5 (b) to protect the interests of consumers, investors and other stakeholder interests, in order to achieve this end, Section 6 (b) vests the ERC with the power to make proposals to the Minister of regulations which may be necessary or expedient for the regulation of the energy sector or for carrying out the objects and purposes of this Act.

his provision is further enhanced by Section 110 of the Act which sets out that the Minister may make regulations for or with respect to any matter that by the Act is required or permitted to be prescribed, or that is necessary or expedient to be prescribed for carrying out or giving effect to the Act and Section 102, which section empowers the Minister to make regulations on various issues specifically concerning petroleum and petroleum products. This power is subject, however, to the recommendation of the ERC.

At Section 102(w), the Act vests in the Minister of Energy the power to determine the retail prices of petroleum and petroleum product& However, the Minister's exercise of this power is made subject to the recommendation of the ERC labeled the Ojodeh Clause by the media, this provision has drawn great controversy particularly in the recent past where there has been public outcry over the exorbitantly high fuel prices instigated by the unfettered market mechanisms in the retail petroleum market in Kenya and calls to the Minister to rein in on the situation by re-introducing direct price control.

Since then, the government seems to be aligning itself with the position that in order to effectively protect the Kenyan consumers and check on arbitrary price fluctuations owing to the failure of the free market system, the retail price of petroleum and its products should be set by law. The authority of government to fix prices to correct maladjustments in the market place was

affirmed by the U.S. Supreme Court in the case of *Nebbia* [200] The case involved the legality of a New York statute providing for the control of milk prices at retail by a state board.

The retail price of milk in New York State was fixed at 9 cents a quart. Leo Nebbia, a grocer in Rochester, sold two (2) quarts of milk and a 5 cents loaf of bread at 18 cents and was convicted of violating the law.

Upon the basis of the maladjustment principle, a majority of the Court affirmed the power of a state government to control prices in a line of business characterized by competition whenever it is reasonably necessary to do so in the public interest. Freedom of contract, held the Court, must give way to public price fixing if the legislature finds that such is necessary for the public good.

The principle of the Nebbia case with respect to price fixing was upheld in the case of West[201] and also in US. vs. Darby [202] where the Court held that the authority for Congress to exercise price control was to be found in the power of Congress to regulate commerce and to make all laws necessary and proper for carrying into effect its delegated powers.

Thus, pursuant to the provisions of Section 102 (w) and Section 110(1) and subject to the provisions of Section 63, the ERC, in response to the plight of Kenyans, exercised its mandate in law and published proposed regulations in respect of the retail pump price of petroleum products and established therein a formula for determining the maximum retail ump price of petroleum products which a person carrying on petroleum business shall dell at a retail dispensing site.[203]

4.3 Shortfalls of the RTPA

Foremost in the inadequacies of the RTPA is found at Section 6(1) (b) of the Act.[204] This section sets out that an agreement or arrangement between manufacturers, wholesalers or retailers to sell

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[200] *Nebbia vs. New York* (1934) 291 U.S. 502

[201] *Coast Hotel 6o. vs. Parish(433)* (1937) 300 U.S. 379

[202] (1941) 312 U.S. 100

[203] The Petroleum Price Regulations, 2009

[204] Ibid,

goods at prices or on terms agreed upon between themselves is one of the categories of trade agreements declared by the Act to be a restrictive trade practice.

It follows that, for this provision to accrue, an agreement proper must exist. Consequently, a pricing offence is deemed to have been committed only if there exists, or has existed, an arrangement or agreement among sellers in the market to influence prices.[205]

This presents a problem because most contracts in restraint of trade are usually not formal.[206] Many a times, parties act in consultation or some form of understanding or forward arrangement without entering into a formal agreement. Such consults or arrangements are, therefore, not captured by the provisions of the Act.[207]

The Act attempts to correct this situation by providing thus at Section 6 (3): "An agreement or arrangement enumerated En subsection (1) shall be regarded as a restrictive trade practice for the proposes of this Act whether or not the agreement or arrangement is intended to be enforceable by legal proceedings"

This means that there is no need for the agreement or arrangement to be a formal contractual agreement. For purposes of the Act, any loose arrangement, understanding, or gentleman's agreement may amount to an agreement under the Act.[208]

However, the restrictive trade practice adopted by the players in the oil industry, namely price leadership, does not require an arrangement or agreement among the sellers or producers of a product for it to be successful in fixing market prices.[209] A dominant company, known as the leader, which fills information about market demand and industry costs simply sets the retail

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[205] Ibid,

[206] Ibid, Class Notes

[207] Ibid,

[208] Ibid,

[209] Ibid, Bhagavan Page 42

prices of its products so that it earns economic profit.[210] The other companies in the industry adopt the same price levels after certain duration of time.[211]

Given that price leadership as a restrictive trade practice does not require a formal agreement for it to be adopted, the requirement by the RTPA for an agreement or management to exist between the parties limits the government's powers and, in effect, ousts the jurisdiction of the Act.

Another limitation of the Act is with regard to implementation of the provisions therein.[212] The penalties prescribed therein for violation of the Act are ineffective as they are unlikely to deter oil companies.[213] This is because the penalties are extremely light yes-a-yes the nature of the offence committed. The Act sets out that any person who is found guilty of adopting a restrictive trade practice shall be liable to imprisonment for a term not exceeding two years or a term not exceeding one hundred thousand or to both.[214] This penalty, in my opinion is very lenient.

Further to this, the nature of the processes of identification and prosecution of an offender are also an impediment to the implementation of the Act. The Act has created a number of enforcement agencies to administer its provisions. These are listed as follows:

1. The Office of the Minister for Finance

2. The Office of the Monopolies and Prices Commissioner who shall, subject to the control of the Minister, be responsible for the control and management of the Monopolies and Prices Department of the Treasury[215]

3. The Restrictive Trade Practices Tribunal[216]

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[210] Ibid,

[211] Ibid,

[212] Ibid,

[213] Ibid,

[214] Section 21 (2) of the Act

[215] Section 3 (2) of the RTPA

[216] Established at section 64 of the RTPA

4. The High Court

The Commissioner plays the key role in inquiries and investigations into alleged restrictive trade practices. Any person who considers himself to be aggrieved as a result of a restrictive trade practice may submit a complaint to the Minister, through the Commissioner, in the prescribed form.[217] Any government agency may also make a complaint on a restrictive trade practice or the Commission may initiate an investigation exproprio motu.[218]

It is the Kenyan consumers that bear the brunt for the high oil prices and the constant price fluctuations endemic to the petroleum market. Naturally, it is the consumers that are the most likely complainants against any restrictive trade practices adopted by the oil companies.[219]

However, the numerous consumers of petroleum products in Kenya are not organized.[220] They are also both spatially and socio-economically diverse[221] it would, therefore, be difficult to develop a commonality of interests on which an effective and strong complaint against the petroleum marketing companies can be based.[222]

The process of identifying alleged restrictive trade practices and prosecuting the persons concerned is cumbersome.[223] As mentioned afore, it is the Commissioner's duty to inquire and investigate into alleged restrictive trade practices. However, certain flaws in the procedures enumerated by the Act raise great concern.[224]

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[217] Section 13 of the RTPA

[218] Section 12 of the RTPA

[219] Ibid, Bhagavan Page 43

[220] Ibid,

[221] Ibid,

[222] Ibid,

[223] Ibid,

[224] Vyas, Y' Competition Law of Kenya: Imperfections and Weakness, university of University of Nairobi, Faculty of Law.

Pursuant to Section 14(1) of the RTPA, the Commissioner is empowered to investigate a complaint made under Section 13 which appears to him to have merit. This means that it is the Commissioner who determines which cases merit investigation and those which do not.[225] However, the Act does not include any guidelines to aid the Commissioner in arriving at his decision.[226]

This oversight gives rise to a number of issues that undermine the overall objectives of the Act. Firstly, an aggrieved party alleging restraint of trade and whose claim has been rejected has no cause of action against the Commissioner[227] Further, this provision creates room for corruption since the Commissioner can easily decide in favour of a party who chooses to employ corrupt tendencies as he does not have a set of guidelines to follow.[228]

Also blemished is Section 15 (1) (b) of the Act which provides that the Commissioner may, with respect to a person alleged to be engaged or to have been engaged in restrictive trade practices, inform the person that, in his opinion, the weight of the evidence supports allegations that have been made concerning the occurrence of a restrictive trade practice, and request the person to desist from it and, in addition, compensate for the past effects of such practices.

This provision, posits Yash Vyas, contravenes one of the principle of natural justice, namely ***audi alteram panem***.[229] This means that no one shall be condemned unheard. This proposition is premised on the fact that the Act at the section cited above appears to give the Commissioner the power to weigh evidence presented by a person alleging the Prepared by commission of a restrictive trade practice, make a decision based on this evidence and actually take action against the alleged violator without affording him an opportunity to defend himself.[230]

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[225] Ibid,

[226] Ibid,

[227] Ibid,

[228] Ibid,

[229] Ibid,

[230] Ibid,

Natural justice demands that any indicted person must be given a fair and reasonable opportunity to defend himself. He has the right to know the accusations leveled against him.[231] He has also the tight to know the premise on which such accusation is based, and a reasonable opportunity to adduce all relevant evidence in his defence.[232]

Section 15 (1)(b) may be faulted on account that it could turn out to be a Pandora's Box with regard to litigation surrounding violation of the principles of natural justice. This is because if an administrative body fails to give a concerned person the right to be heard, whatever decisions it makes will be invalidated upon review. Consequently, any decision made by the Commissioner founded on the contentious section may be the subject of judicial review.

Reference may be made to the case[233] where the Commissioner of Prisons purported to deprive Onyango Oloo his sentence remission without giving him an opportunity to be heard which remission he was entitled to under Section 46 of the Prisons Act[234] Quashing the Commissioner's decision, Justice - Nyarangi stated as follows: "There is a presumption in the interpretation of statutes that the rules of natural justice will apply in this case, the rule in question was the one concerning the right to be heard.

A glaring omission in the provisions relating to the implementation of the Act is that no time limits action by the enforcement agencies have been stipulated by the Act.[235] In the first instance, the duration of an investigation into an alleged restrictive trade practice by the Commissioner has not been laid down [236]Further, the period within which the enforcement agencies are supposed to decide a case presented to them is not prescribed.[237] This is a serious lacuna in the law which can

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[231] Bansal, AK, Departmental Enquiries and the Rules of Natural Justice

[232] Ibid,

[233] *Onyango Oloo vs. The Attorney General* (Civil Appeal No. 152 of 1986)

[234] Chapter 90 of the Laws of Kenya

[235] Ibid, Vyas Y

[236] Ibid,

[237] Ibid,

result in harm to the aggrieved party as a case may drag on for a long period of time.[238] Business efficacy demands that such matters be settled expediently and with finality.

Most practices in restraint of trade are hard to prove[239] This is alleviated by the fact that some provisions on restrictive trade practices, as espoused in the Act, are characterized by vagueness and a paucity of economic analysis[240] The Kenyan law has various convoluted provisions which require simplification Reference may, for example, be made to the general definition of restrictive trade practice as provided at Section 4 (1) of the RTPA which is very complicated and has facets that are difficult to prove,

With specific reference to the petroleum industry, proving price leadership is an uphill task.[241] Price leadership, as discussed above, is an industry practice in which one firm's pricing movements are followed by its rivals.

Price leadership is a phenomenon that is difficult to judge. It can constitute a facilitating practice as the price leader indicates the preferred 'focal' consensus price or output level 7 but can, on the other hand, also is merely the natural working of the market.[242]

Owing to the above reasons, the industry players,, particularly the well-established firms, do not view the violation of the Act as a perilous undertaking. The Act has little, if any, deterrence power. In this regard, the Act is ill equipped to enhance competition in the oil industry owing to the flaws inherent therein[243].

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[238] Ibid,

[239] Ibid, Class Notes

[240] Ibid,

[241] Ibid,

[242] Baine, JS; Price Leacers, Barometers and Kinks, Journal of Business Vol. 33 (1969) Page 283

[243] Vyas, Y' Competition Law of Kenya: Imperfections and Weakness, university of University of Nairobi, Faculty of Law.

4.4 The Petroleum Price Regulations, 2009

the Petroleum Price Regulations, hereinafter the Regulations, were published by the ERC pursuant to the provisions of Section 110 (3) which requires the body, before making recommendation of any regulations to the Minister, to publish any proposed regulations for purposes of inviting proposals from the public at least forty (40) days before the regulations are submitted to the Minister.

Vide Regulation 3 of the said Regulations; the ERC establishes a formula for determining the maximum wholesale and retail pump price of petroleum products at a wholesale depot and a retail dispensing site. The Regulations are categorical in providing that the prices determined using the formula set out therein shall be the maximum wholesale and retail pump price of petroleum products which a person carrying on petroleum business hall sell at a wholesale depot and at a retail dispensing site.

Pursuant to Regulation 2, 'petroleum products' means Super petrol, Regular petrol, kerosene and Automotive Diesel. A 'wholesale depot' has been defined as the petroleum receipt, storage and truck loading facilities owned by companies carrying on petroleum business in Mombasa and Nairobi and by the Kenya Pipeline Company in Nakuru, Eldoret and Kisumu while 'retail dispensing site' means premises where petrol is stored in bulk in one or more tanks and dispensed to consumers for their own use and includes filling and service stations.

The formula for determining the maximum wholesale pump price for Super Petrol, Regular Petrol, Kerosene and Automotive Diesel in shillings per litre is set out by Regulation 4 (a) thus:

$$P_{w} = C_{w} + K + L + M_{w}$$

Where,

P_{w} = Maximum Wholesale Price for Super Petrol, Regular Petrol, Kerosene and Automotive Diesel

C_{w} = Weighted average cost in shillings per litre cx the Kenya Petroleum Refineries Limited (KPRL) and ex Kipevu Oil Storage Facility (KOSF,).

K = The transportation cost from Mombasa to the nearest wholesale depot and is made up of x percent of pipeline tariff (K2) and (100- x) percent of mad bridging cost (Kra) as set out in Schedule J hereto.

L = Allowed losses in the pipeline (Lb) and in the depots (Ld) as per Schedule 2 hereto.

M_w= Allowed oil marketing company 's gross wholesale margin as per Schedule 3 hereto.

The formula for determining the maximum retail pump price for Super Petrol, Regular Petrol, Kerosene and Automotive Diesel in shillings per litre is set out by Regulation (b) thus:

$$P_r = P_w + M_r + z$$

Where,

P_r= Maximum Retail pump price of Super Petrol, Regular Petrol, Kerosene and Automotive Diesel applicable in shillings per litre.

P_w = Maximum Wholesale Price for Super Petrol, Regular Petrol, Kerosene and Automotive DieseL

M_r= Allowed maximum retail gross margin as per Schedule 3 hereto.

z = delivery rate from the nearest wholesale depot to a retail dispensing site in shillings per litre as set out in Schedule 1 hereto.

$$C_y = \frac{\sum_{trp} V(C_{trp} + T + F) - \sum_{crp} V(C_{crp} - T - S_d)}{\sum(V_{trp} - V_{crp})}$$

Where,

V_{trp}= average volume of the refined petroleum products imported through the open tender system in the previous three months in litres.

C_{trp} = average unit cost of the refined petroleum products imported through the open tender system in the previous three calendar months in shillings per

V_{crp}= average volume of the petroleum products obtained from crude refined at KPRL in the previous three calendar months in litres.

C_{crp}average unit cost of petroleum products obtained from crude refined at

KPRL in the previous three calendar months in shillings per litre.

T= total taxes and levies for petroleum products in shillings per litre

$T = (t_{ed} + t_{rml} + t_{pdl} + t_{prl})$

t_{ed}=Excise Duty.

t_{rml}=Road Maintenance Levy.

t_{pdl} =Petroleum Development Levy.

t_{prl}= Petroleum Regulation Levy.

F = KOSE Charges which shall be $3/ M^3 + VAT

S_d =Excise Duty Remission which shall be Kshs 0.45 per litre for Super Petrol ant/Regular Petrol and Kshs 0.31) per litre Kerosene and Automotive Diesel.

Pursuant to Regulation 5, the unit cost of imported refined petroleum products $[C_{irp}]$ shall

be determined in accordance with the calculation used in the open tender system for importation of petroleum products and the unit cost of refined petroleum products $[C_{crp}]$ shall 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 in accordance with Regulation 6 thereto.

The Regulations go further to enumerate the pipeline tariff chargeable, the delivery rates and bridging rates, the maximum operational losses allowed to a person carrying on petroleum business and the maximum allowed wholesale and retail margins afforded to persons carrying on

petroleum business in Schedules 1, 2 and 3 respectively. They also prescribe penalties for contravention of the rules made therein. A person convicted of an offence under these Regulations shall be liable to a fine not exceeding one million shillings or the withdrawal of the operating license or both.[244]

The Regulations do not necessarily fix the pump prices of petroleum; rather, they spell out a mechanism for determining 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 a retail dispensing site,

The Regulations, as they stand presently, are not fixed; the ERC is allowed to review the calculation of the maximum wholesale and retail pump prices of petroleum products determined under Regulation 4 of these Regulations as and when it may deem fit for purposes of monitoring compliance, in accordance with Regulation 9. The Minister may also review the formula mentioned under Regulation 4 as and when he may deem fit. The Regulations have, however, not been approved by the Minister.

4.4 Conclusion

Whereas the Act gives the Minister the power to curtail rise in oil prices by fixing the retail prices of petroleum and petroleum products, he can only do so upon the recommendation for such action by the ERC. The Minister of Energy has, however, not put this power to use despite the glaring need for its employment, citing the need for Kenya to maintain a market-oriented economy as his justification.

This, in essence, renders the pricing of petroleum and petroleum products at the mercy of multinational corporations and the dynamics of the international market because Kenya's free market economy stance has shown that it cannot realistically protect the interests of consumers. This begs the question whether the law is actually serving its purpose or not. What is the use in vesting the power to fix prices of petroleum and petroleum products in the Minister if the power

[244]Regulation 3 (4)

is open to such interpretation and manipulation? The Minister's interpretation of his mandate defeats the objects of the Energy Act and National Energy Policy and renders the law powerless to serve its purpose.

The Energy Act, in conformity with the National Energy Policy, is geared towards, Inter alia, enhancing security of supply of energy and promoting energy efficiency, the division of sustainable quality energy services for purposes of development, the improvement of access to affordable energy services and the provision of an enabling environment for the provision of energy services.[245] The overall objective of the Energy Policy is to utilize energy as a tool to accelerate economic empowerment for urban and rural development.[246]

Vide the antiquated the American case[247], the Court introduced the common law position into the American law when it stated that when competitive conditions are absent, business firms, holding themselves out as selling to the public, are affected with a public interest and government has the power and the duty to impose just and reasonable prices. It is my assertion that this duty persists even in the face of our liberalized market.

The subsisting provisions with regard to the direct control of prices of petroleum and petroleum products is not sufficient to curtail the constant hikes on the retail price of petroleum products endemic to our local oil market. The provision does not sufficiently secure the interests of the Kenyan consumers. This is because the power, as it is vested in tile Minister, is not absolute, but discretionary. Even after research into the matter by the BRC and invitation for proposals thereon from the public, the final decision rests upon the Minister. In this regard, this power is open to manipulation by the Minister. The recommendations by the ERC may be sound and in the best interests of the stakeholders involved but the Minister may still refuse to validate them

[245] UNEP Report on Kenya: Integrated Assessment of the Energy Policy with Focus on the Transport and Household Energy Sectors

[246] Ibid

[247] *Munn vs. Illinois* 94 U.S 113 (1877)

on account of, for example, selfish political pursuits. This, the researcher contends, undermines the goals of our National Energy policy and, indeed, those of the Energy Act.

Also noteworthy is that the Minister can only implement this power upon recommendation by the ERC. In accordance with Section 110 (2), the ERC may make regulations on its own motion or upon proposal by a licensee or any other person. It follows, necessarily, that is the duty of the Commission to carry out the essential research prerequisite to sound and viable policy recommendations and this may in fact be inferred from Section 5 at sub-sections (e)-(h) of the Act.

In providing that the Minister can only make regulations subject to recommendations thereon by the ERC, this requirement protects from arbitrary abuse of power by the Minister. This is enhanced further by Section 4 (3) of the Act which empowers the Commission thus:

"Except as otherwise provided in this Ac4 the Commission shall be independent in the performance of its functions and duties and exercise of its powers and shall not be subject to the direction or control of any person or authority"

The independence of the ERC is of utmost importance and it must be protected from political interference.

However, it is my submission that the Act errs by failing to enumerate the considerations that the Commission should take into account in making its recommendations. This, I opine, gives room for abuse of power by the Commission. It is not enough that the Act gives a fortification of stakeholder's interests; it should follow this through by setting guidelines to be followed in implementing its provisions. The possibility of subjective recommendations by the Commission cannot be ruled out,

The researcher is strongly persuaded that the Act also falls short by failing to further create an elaborate procedure through which the Commission can regulate prices in the oil industry, other than making recommendations to the Minister in charge. The Act, which is meant to apply to "every person or bodies of persons... importing, exporting, transporting, refining, storing and selling petroleum or petroleum products... and to all works or apparatus for any or all of these purposes", raises fundamental questions with regard to the functions and objects and, more

specifically, the regulation of the sale of petroleum as envisaged under Section 5 (a) (ii) and 5 (b) thereof.

The ERC should be given a more active role than it has right now. To give the Commission the duty of making recommendations only is to undermine the Commission and also to deny it the role for which it was conceived. Current recommendations still lay unattended to.

The provision for the maintenance of strategic stock at Section 97 goes a long way in guaranteeing security in the supply of petroleum products. Indeed, the provision seeks to ensure continuity of supply of petroleum products in case of the disruption of supply of the products.[248] In so doing, The Act is able to somewhat stabilize domestic prices of petroleum products and also reduce the impact of the dynamics of the international oil market on our local petroleum market,

As discussed above, the Petroleum Price Regulations, 2009 establish a formula for determining the maximum wholesale and retail pump price of petroleum products which a person carrying on petroleum business shall sell at a wholesale depot and a retail dispensing site. It is important that the formula at any one time arrives at a price that safeguards the interests of the consumers and affords the investors appropriate returns on their investment on the one hand, and allows the industry players to maintain financial integrity, attract capital, cover overheads and other operational costs and generally operate efficiently on the other hand.

The retail price of petroleum products in Kenya is made up of four main cost groups which are listed as follows: [249]

e) Procurement, refining and storage costs;

f) Inland delivery costs;

g) Profit margin;

h) Government taxes.

[248] Regulation 3 (2)(b) of The Energy (Petroleum Strategic Stock) Regulations, 1008

[249] Ibid, Bhagavan Page 35

The pricing formula set out in the Regulations incorporates the various cost factors that make up the pricing mechanism of fuel as discussed in Chapter Two of this research. Schedule III of the Regulations enumerates the maximum wholesale and retail margins allowed to the industry players for super petrol, regular petrol, kerosene and automotive diesel.

Generally, the researcher believes that the proposed pricing formula is good for the country as it is transparent and predictable. The end result of this formula is that the consumer will only pay for prudently incurred costs and this will translate, hopefully, to fairer retail prices and this is what the country needs in the face of the ongoing world economic crisis. The petroleum sub-sector is pivotal to the development of the country and protection should be afforded to the sub-sector particularly during these difficult times.

CHAPTER FIVE

CONCLUSIONS AND POLICY RECOMMENDATIONS

Sessional Paper No. 1 of 1986 on 'Economic Management for Renewed Growth' emphasized the importance of unfettered economic development steered by the private sector. Indeed, it implored the government to establish market-based incentives and regulatory structures that will channel private activity into areas of greatest benefit for all Kenyans.[250] In doing so, the Paper set out that the government will rely less on instruments of direct control and increasingly on competitive elements in the economy.[251]

Other Policy documents, particularly Sessional Paper No. I of 1994 on 'Recovery and Sustainable Development to the Year 2010' re-affirmed the free market economy stance that Kenya had chosen to pursue in her quest for economic growth.

However, it is well established that the free market is not an end in itself; but a means to achieving economic efficiency. The reality is that markets have imperfections and, thus, will never work properly. Competition in the market place is vitiated by restrictive trade practices adopted by some firms in the process of competition in their quest to attain concentration of economic power.[252] Indeed, in much of the period subsequent to the deregulation of the petroleum sub-sector, the local oil market has repeatedly failed to send price signals that allocate economic resources efficiently.[253]

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[250] Sessional Paper No. 1 of 1986 on Economic Management for Rebewed Growth, Paragraph 2.53

[251] Ibid

[252] Boudreaux, Donald J and Kleit, Andrew N: Cleaning Hands in Predation Cases: A Modest Proposal to Improve Predatory Pricing Suits.

[253] See http://www.gasandoil.com.goc.marketintelligence/picoenergy.east-africa-country-report.htm (Last accessed on 29 April 2011)

"The life of the law has not been logic, it has been experience," wrote Oliver Wendell Holmes in 1881. [254]Faced with the inadequacies of the existing legal and regulatory framework in the petroleum sub-sector, coupled with the weaknesses of free market economics and the failure by our national petroleum policy to check on the arbitrary fluctuations in the prices of petroleum products, Holmes' admonition calls for a new audacity in the regulation of our local petroleum industry. Our system of regulation must keep up with society. As society advances, so must the law. If it fails to keep up, it will dissuade the economic expansion indispensable to meet the challenges of the 21st century.

The pricing of petroleum and petroleum products is too important to be left to market forces as this, as we have seen in previous chapters, is very easily subject to manipulation. Kenya's free-market economy stance has shown that it cannot realistically protect the interests of consumers. An examination of the petroleum sub-sector subsequent to its deregulation has shown that security and efficiency in the supply and distribution of petroleum and its products has not yet been achieved. It is on this premise that the researcher advocates for direct control by the government of the price of petroleum and petroleum products.

The Regulations will ensure that the local retail prices of petroleum products correspond to the changes in international oil prices, When there is a rise in the international oil Prepared by Prices, the Regulations will ensure that only prudently incurred costs will be borne by the consumers and when the oil prices are filling, they will guarantee that the Kenyan citizenry will be able to benefit therefore much sooner than the current rate. This formula was negotiated in a positive spirit, with wide consultation between the ERC, tie industry players and various stakeholders. It is my proposition that the Minister for Energy should approve these Regulations and thereby give them the force of law.

Creating a competitive business environment is essential to the operational efficiency of the petroleum sub-sector However, the Kenya petroleum market is dominated by profit- driven almost monopolistic multinational companies who manipulate the local market in their quest for

[254] See http://law.jrank.org/pages/7914/Jurisprudence-Realism.htm (Last accessed on 5 February 2011)

maximization of profits.[255] The level of competition in Kenya's oil industry spells inefficiency and ineffectiveness.[256] These companies do not adhere to the principles of free market competition. Inherent in the market are practices that are restrictive to trade and which deter competition in the market.[257] Price leadership, which economic theory tends to associate with oligopolistic pricing behavior, has been adopted Prepared by the oil industry in Kenya as the mode of pricing mechanism,[258] this has denied the economy the inherent gains of the free market and competitive pricing of petroleum products.

It is the researcher's submission that the law must be as dynamic as the changes that occur in the market place The RTPA should be reviewed so that it can be able to capture this and other restrictive trade practices rife in the local petroleum market.

Also key to enhancing competition in the petroleum sub-sector is reducing barriers to entry into the industry. It is well established, the researcher believes, that the Kenyan petroleum sector is characterized by prohibitive entry barriers to petroleum trading in the country, thereby sustaining the oligopolistic structure of our oil market. With the removal of market entry barriers and gradual development of sizeable market shares by new economic players, the level of competition will improve and the currently high gross profit margins will fall over time[259]

Aligning itself with the position that the price of petroleum and its products should be set by law, the ERC, published The Petroleum Price Regulations, 2009, geared towards direct control of the wholesale and retail price of petroleum and its products. The Regulations do not fix a maximum price for the wholesale and retail of petroleum products; rather, they establish a formula for determining 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 a retail dispensing site.

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[255] Ibid, Bhagavan Page 43

[256] Ibid

[257] ibid

[258] Ibid, Bhagavan Page 107

[259] Ibid, Bhagavan Page 49

The overriding concern of the government in levying taxation on petroleum products has been targeted at the maximization of revenue. Consequently, retail pump prices of petroleum and its products reflect the high government taxes and levies imposed on petroleum products. This is because the oil marketers pass on the taxes and statutory levies imposed on them to the consumers at both the wholesale and retail levels and this is reflected in the price that the end-user has to pay for any petroleum products.[260]

Further, the cross-subsidization policy leads to price distortions which may have effects across the entire economy.

Taxes have not been used to finance petroleum marketing infrastructure development.[261] The PDL, expressly set up in 1990 to provide for development funds for establishing and retail infrastructure in areas not adequately served by the existing oil companies, has not been used for that purpose.[262] It is believed that the Treasury is using the PDL to finance the fiscal budget deficit, contrary to the legal criteria governing the application of such funds.[263]

The PDL as a source of investment capital in supply and retail outlets for petroleum fuels has not worked.[264] This levy should, therefore, be abolished to ease the pressure of unnecessary taxation on the Kenyan citizenry indeed; this measure would be consistent with the government's policy that the PDL should not be used to support activities in competition with the private sector.

Further to this, the petroleum tax structure should be rationalized with a view to reducing extreme price distortions.[265]

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[260] Bhagavan Page 46

[261] Bhagavan Page 108

[262] Ibid,

[263] Ibid,

[264] Bhagavan Page 110

[265] Ibid, Bhagavan Page 109

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