



COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 48/CR/Aug10

[011502]

In the matter between:

THE COMPETITION COMMISSION OF SOUTH AFRICA

Applicant

and

SASOL CHEMICAL INDUSTRIES LIMITED

Respondent

Panel : Yasmin Carrim (Presiding Member)
Andreas Wessels (Tribunal Member)
Merle Holden (Tribunal Member)

Heard on : 13 May to 07 June 2013; 20 and 21 June 2013; 22 August 2013; 26 to 30 August 2013; closing arguments on 14 and 15 October 2013;
further submissions on 19 February 2014, 03 March 2014, 10 April 2014, 23 April 2014, 30 April 2014 and last submission received on 09 May 2014

Order issued on : 05 June 2014

Reasons issued on : 05 June 2014

EXECUTIVE SUMMARY

1. This is a case referred by the Competition Commission ("Commission") to the Competition Tribunal ("Tribunal") against Sasol Chemical Industries Limited ("SCI") about alleged excessive pricing in two vertically related markets over a period of four years from January 2004 to December 2007.

2. The Commission alleges that SCI charged excessive prices to domestic customers of purified propylene and polypropylene.
3. Section 8(a) of the Competition Act of 1998¹ (“the Act”) provides that it is prohibited for a dominant firm in a relevant market to charge an excessive price that is to the detriment of consumers. An excessive price is defined as a price for a good or service which bears no reasonable relation to the economic value of that good or service and is higher than that economic value. The Act however does not contain a definition of economic value.
4. Purified propylene, produced from feedstock propylene, is an input in the production of polypropylene. An excessive price in respect of purified propylene would therefore have a knock-on effect on the cost of polypropylene. Polypropylene is a key input for converters who manufacture industrial and household plastic products. An excessive price for polypropylene would therefore have an effect on the costs of producing finished plastic products. Hence the price of both purified propylene and polypropylene, as intermediate products, would have significant relevance to the price of household plastic goods such as buckets, brooms, storage containers and industrial products such as motor car parts, water tanks and the like, and the ability of these producers to compete with imports.
5. Feedstock propylene is produced in abundance in South Africa by Sasol Synfuels (“Synfuels”), as a by-product of Sasol Limited’s fuel production. Synfuels sells this feedstock to SCI who in turn uses this to produce both purified propylene and polypropylene. Both Synfuels and SCI are subsidiaries of Sasol Limited (“Sasol”).
6. Purified propylene is not a traded good, i.e. it is not exported from South Africa. SCI has one domestic customer of purified propylene, Safripol (Pty) Ltd (“Safripol”). SCI supplies polypropylene to domestic customers at import parity pricing (IPP) and also exports vast quantities of polypropylene to various international export destinations.

¹ Act No. 89 of 1998, as amended.

7. We have found that SCI is a dominant firm in terms of section 7 of the Act in both relevant markets namely the production and sale of purified propylene and polypropylene in South Africa.
8. We have also found that SCI charged domestic customers excessive prices for both purified propylene and polypropylene during the abovementioned complaint period.
9. In the judgement of the Competition Appeal Court (CAC) in *Mittal Steel South Africa Limited ("Mittal") and others v Harmony Gold Mining Company Limited and Another*² ("Mittal (CAC)"), the court confirmed that an analysis of a complaint under section 8(a) of the Act involves a number of steps including: (i) the factual determination of the actual price of the good or service in question alleged to be excessive and (ii) the economic value of that good or service; as well as the exercise of value judgments as to (a) whether the difference between the actual price and economic value is unreasonable; and (b) if so, whether the charging of the excessive price is to the detriment of consumers.
10. The CAC remarked that one way of considering the notion of "economic value" was to conceptualise it as the long-run competitive equilibrium (LRCE) in a competitive market. However while LRCE could serve as a useful concept, this was merely notional.
11. In that case the CAC further made it clear that different methods may be employed in an excessive pricing enquiry to ascertain the economic value of the good or service concerned. Such an approach is consistent with approaches adopted and recommended by other jurisdictions.
12. The experts in this case employed the following methods: price-cost tests, a comparison of domestic prices with prices in other geographic markets, and a comparison of SCI's export prices with domestic prices for each product. These were labelled as "Mittal 2" type tests by SCI. On the basis of these tests we have found the results set out below.

² Case number 70/CAC/Apr07 [2009] ZACAC 1.

Results for purified propylene

13. *Price-cost test*: On the basis of a price-cost test we found that the markups of purified propylene prices over actual costs during the complaint period were in the range of [39.9 – 41.5]% for Tier 2³ sales to Safripol and in the range of [25.1 – 26.5]% for Tier 1 sales to Safripol. For the average of Tier 1 and Tier 2 prices, this figure is in the range of [31.5 – 33]%.
14. *Export price comparison*: Purified propylene is not exported from South Africa; the purified propylene is converted to polypropylene which is exported (*inter alia* by SCI). There is therefore no export price for purified propylene to use directly in this analysis. The Commission thus sought to measure the economic value of purified propylene based on the export prices of polypropylene. It did so by imputing a purified propylene price from polypropylene exports using the price formula in the Safripol Supply Agreement. However, at a level of principle we found that one cannot attach any significant weight to the Commission's imputed export price for purified propylene. This method thus did not assist us.
15. *Prices charged by other firms in other geographic markets*: While we would have preferred to look at a preponderance of evidence, we were unable to do so in the case of purified propylene since we found that there were no appropriate comparators for purified propylene in other geographic markets for the period under review.
16. We have found that the above price-cost test as performed by both parties in relation to purified propylene in this case provides a more reliable method of determining the economic value of the purified propylene sold by SCI in South Africa during the complaint period.

³ SCI charged Safripol two prices. The so-called "Tier 2" sales to Safripol were at a significantly higher price than the "Tier 1" sales.

Results for polypropylene

17. *Price-cost test*: The final results of the price-cost test depict the following –

17.1. measured on a very conservative basis, SCI's markup of its polypropylene price over actual costs during the complaint period was in the range of [17.6 – 25.4]%; and

17.2. measured on a more realistic basis as discussed in detail in our reasons, SCI's markup of its polypropylene price over actual costs during the complaint period was in the range of [26.9 – 36.5]%.

18. *Export price comparison*: Comparing the average export netback price for deep sea exports of polypropylene to SCI's local prices show that SCI's local prices for polypropylene over the relevant cycle (FY02 – FY08) were on average 23% higher than average deep sea export prices.

19. *Polypropylene prices of other firms in other domestic markets*:

19.1. USA domestic polypropylene prices: Given that the USA is not a low cost producer of polypropylene we found that the prices charged by USA polypropylene producers are not suitable comparators to SCI's prices.

19.2. European domestic polypropylene prices; We have found that SCI's domestic prices charged for polypropylene were 41% and 47% higher for homopolymer and raffia grade polypropylene respectively in the complaint period compared to the discounted prices in Western Europe computed on the basis of feedstock costs comparable to SCI.

20. SCI also advanced a fourth approach, namely to determine economic value directly, in other words to postulate a hypothetical market with notional competitors and their prices and costs in that market. This was referred to in our proceedings as the "Mittal 1" approach. SCI selectively relied on the second sentence of paragraph 40 of the CAC decision in support of this argument. We do not accept that the CAC in Mittal establishes such distinct legal tests but rather that the CAC, in its discussion, was providing the Tribunal with a conceptual framework and some guidance on how excessive pricing enquiries could be

conducted. Furthermore, whilst Mittal 1 was an extremely interesting theoretical debate in our proceedings, having given careful consideration to both sides' submissions we have found their submissions unpersuasive.

21. After assessing the various methods to determine the economic value of purified propylene and polypropylene respectively sold by SCI during the complaint period, we assessed whether the prices charged bore a reasonable relation to the economic value of the respective products. We were urged by SCI not to come to a conclusion of unreasonableness unless the difference between the price and the economic value of the product was at least 50%. However we stress, and this was confirmed by SCI's expert witness, that there is no universal reasonableness threshold that would apply to all products, across all markets and across all jurisdictions.

22. In assessing whether a price bears a reasonable relation to its economic value, due regard must be given to the ultimate objective and the policy and principles underlying the prohibition on excessive pricing in the context of our Act. Our approach to section 8(a) of the Act must be placed in the context of the South African economic history. The Act was promulgated in 1998 to reverse a long history of economic exclusion for the vast majority of citizens, to promote growth and development and to address unacceptably high levels of concentration in the economy.⁴

23. We also had regard to the history of state support enjoyed by Sasol in the past and the reasons for Synfuels' cost advantage in the production of feedstock propylene. Synfuels is one of the lowest cost producers of feedstock propylene in the world. Feedstock propylene is produced in abundance as a by-product of Sasol's liquid fuels production. Because of its low feedstock propylene costs, SCI is a low cost producer of purified propylene. SCI is also one of the lowest cost polypropylene producers in the world.

24. The Commission argued that the Tribunal should take this feedstock advantage into account in its excessive pricing enquiry. SCI was of the view that we should ignore this advantage. We ultimately have found no justification for the

⁴ See the Preamble to the Act.

elimination of Sasol's low cost of feedstock propylene from the evaluation of SCI's prices.

25. Sasol was supported, owned and controlled by the State from its establishment until its privatisation and to some extent beyond privatisation. Due to the strategic nature of the sector, the State ensured, through legislation and regulation, that Sasol was sustainable, profitable and would not fail. The most significant legislative, regulatory and other measures imposed by the State to protect and benefit Sasol in particular comprised:

- 25.1. the protection of the synthetic fuel industry as a feature of public policy;
- 25.2. an arrangement that service stations would purchase Sasol's fuel product and market it. This insulated Sasol from marketing risks since it did not have to invest in a retail network;
- 25.3. fuel levies imposed on consumers of fuel that were used to fund Sasol 2 and Sasol 3. The Sasol 2 levy fluctuated with the crude oil price so as to keep Sasol (2) revenues constant;
- 25.4. a rail equivalent tariff which had the result of exempting Sasol from paying the higher transport costs resulting therefrom. The tariff had the further effect of raising the inland price and thus increased Sasol's returns;
- 25.5. Sasol's utilisation of state funded infrastructure such as pipeline networks;
- 25.6. minimal risk posed to investors when Sasol was privatised;
- 25.7. the other oil companies having to buy Sasol's fuel and agreeing to shut back their own production when Sasol 3 came on stream;
- 25.8. the State taking a decision to locate Natref inland at Sasolburg, and
- 25.9. Sasol was exempted from paying crude oil transport costs, which costs were borne by the motorists through a levy.

26. It was argued by SCI that this support, in money terms, has all been repaid by Sasol to the State. However the nature of the advantage, conferred upon Sasol and its subsidiaries through considerable and prolonged state support, is not one that can only be expressed in monetary terms, but is also one that has had the effect of creating SCI's dominance that has endured into the current market(s) under consideration. How that dominance came about is therefore significantly relevant to the enforcement of the Act.
27. We have found that SCI's low cost of feedstock propylene arises from South Africa's natural resources and the response of Sasol historically to the need to produce liquid fuels. Sasol benefitted from significant state support over an extended period of time and its market positions in purified propylene and polypropylene are a consequence of that; those positions are not the result of risk taking and innovation on its part in those markets. The evidence has shown that SCI relies on the same standard technology as all other producers of purified propylene and polypropylene.
28. After having regard to the nature of the products, their importance as intermediate inputs in industrial development, market characteristics and circumstances, the objects of our Act understood in the context of the South African economy, the history of the dominant firm and how it acquired its dominance, we find that the purified propylene and polypropylene prices charged by SCI during the relevant period bear no reasonable relation to the economic value of these products.
29. Furthermore we find that the purified propylene prices charged by SCI to Safripol (a competitor of SCI at the polypropylene level, as explained in these reasons) during the infringement period was to Safripol's detriment and inhibited its ability to effectively compete with SCI. In addition, SCI's locally charged polypropylene prices have had a significant adverse effect on the local plastic converters and caused them harm during the complaint period.
30. Given that consumer harm was demonstrated we found that SCI contravened section 8(a) of the Act by charging excessive prices for both purified propylene and polypropylene during the complaint period.

31. As a result of its dominance, SCI has been able to maintain excessive prices in both product markets. In purified propylene it has been able to charge its only customer, Safripol, a competitor in the downstream polypropylene market, a price that counter-intuitively increases with increases in volume and has also been able to restrict the monthly volume of the lower priced "Tier 1" purified propylene sold to Safripol. In the polypropylene market, SCI has segmented the market between the high priced local (domestic) and the lower priced export market by selling exports on a delivered basis, thus preventing arbitrage in the domestic market by re-entry of its cheaper polypropylene. We make the observation that these excessive prices, maintained by an exercise of market power by SCI, have resulted in a missed opportunity for innovation and development for the domestic manufacture of downstream plastic goods. Cheaper polypropylene prices for local plastic converters could enhance local production thereby enabling them to compete more effectively with imported final plastic products, manufacture locally rather than overseas and introduce new products to South African consumers adding to their choice of product through greater innovation.
32. With regards to remedies, the Commission had sought a penalty of 10% of total turnover as well as forward looking pricing remedies. In the course of the proceedings the Tribunal asked SCI whether it wished to propose any alternative remedies to those put forward by the Commission and SCI declined to do so.
33. In arriving at the remedy we had regard to a number of factors as set out in section 59 of the Act. We noted that Sasol had previously been found to have contravened the Act, albeit in different markets. Had we elected only to impose an administrative penalty, given the above considerations, the penalty would likely have been much closer to 10% of total turnover. However we also considered whether the imposition of an administrative penalty on its own would necessarily be appropriate in this case, given the characteristics of the markets and the role of these intermediate products in industrial development. We are persuaded that a reduced penalty together with the imposition of a "forward looking" behavioural remedy in relation to both product markets would provide both relief and certainty to SCI and its customers and would therefore be more appropriate.

34. These remedies must be viewed in light of the significant harm that SCI's excessive prices for purified propylene and polypropylene have caused their customers that use these intermediate products in their own production processes, leading ultimately to negative consequences for our emerging economy.

35. Accordingly we have imposed the remedies set out below.

36. In respect of purified propylene:

36.1. An administrative penalty of R205.2 million which is to be paid to the Commission within 90 days of date hereof; and

36.2. SCI must not discriminate between the purified propylene price charged internally within Sasol and the price charged to customers such as Safripol;

36.3. SCI and the Commission must within 90 days hereof submit a proposed pricing remedy to the Tribunal which remedy must include the following:

36.3.1. A formulation in which the price of purified propylene to customers in the domestic market is determined by applying the R ratio⁵ to a benchmark which must be developed by reference to a region(s) in the world with the lowest polypropylene prices;

36.3.2. A provision for the review of the benchmark from time to time so as to ensure that the lowest price purified propylene is delivered to domestic customers, and/or

36.3.3. Alternative remedies to achieve the objectives envisaged in 36.3. 1 above.

⁵ R ratio being the average international propylene price : polypropylene price ratio based on the average of the average North-West European and average USA polypropylene and propylene contract prices.

37. In respect of polypropylene:

- 37.1. An administrative penalty of R328.8 million which is to be paid to the Commission within 90 days of date hereof; and
- 37.2. SCI must sell polypropylene on an ex-works basis without discriminating in price between any of its customers no matter where they are located.