Excessive pricing in Mittal and Sasol

A view on the role of competition policy versus industrial policy

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1 Introduction

The new South African competition regime under the Competition Act 89 of 1998 (the Act) is now 15 years old. A recurring theme during this time was the role of public interest and specifically that of industrial policy in creating a more competitive economy. The two recent excessive pricing cases (Mittal and Sasol) have highlighted the respective roles of industrial and competition policy. However, the conflicting outcomes from these cases illustrate the inability of competition policy to fully address historic pricing power imbalances that are the result of the industrial structure in a sector. It is also evident that the Competition Tribunal (Tribunal) and the Competition Appeal Court (CAC) may have different interpretations of the excessive pricing definition under Section 8(a) of the Act, which brings into question the usefulness of using competition policy, specifically the excessive pricing clause, to address highly concentrated capital-intensive upstream markets. Therefore, other options to address the concentrated market structure need to be considered. Consequently, this paper argues that industrial policy might be better suited to perform this function.

Section 2 discusses the role of competition policy in South Africa, while Section 3 elaborates on the role of industrial policy. Section 4 discusses the overlap between these policies, namely the need to address highly concentrated upstream capital-intensive industries and their ability to price at Import Parity Prices (IPP). Given that the recent excessive pricing cases have highlighted the roles of these two policies w.r.t. addressing this issue, Section 5 discusses both the Mittal and Sasol cases and how their outcomes differed. Subsequently, Section 6 illustrates the problems associated with using competition policy to address pricing power in South Africa, while Section 7 discusses the views of different policymakers regarding this issue, as well as possible options for addressing the highly concentrated upstream markets.

2 The role of Competition Policy

The Competition Commission, the Competition Tribunal and the Competition Appeal Court are statutory bodies constituted in terms of the Competition Act. They are functionally independent regulatory authorities, who are administratively accountable to the Department of Economic Development.[1] Under the mandate of the Competition Act, the Competition Commission is responsible for addressing concentrated markets and anti-competitive practices to, *inter alia*, "promote the efficiency, adaptability and development of the economy." The Commission is responsible for investigating and enforcing the Act, while the Tribunal performs an adjudicative function and the CAC considers appeals lodged against the Tribunal's decisions.[2]

The Competition Commission is tasked with investigating, controlling and evaluating "restrictive business practices, abuse of dominant positions and mergers in order to achieve equity and efficiency in the South African economy".[3] It is therefore responsible for promoting and

[1] Competition Commission of South Africa. 2015. *Who are we?* Available at: http://www.compcom.co.za /who-are-we/. Accessed on 20 February 2015.
[2] Ibid
[3] Ibid

maintaining competition in South Africa. The Preamble of the Act sets the background against which the Commission aims to achieve its goals, as well as its policies to achieve these goals. It recognises the country's divided history and sets forth a mandate to achieve greater ownership and to focus on development in order to provide South Africans with a more effective and efficient economy, access to all markets and protection against uncompetitive practices.[4]

3 The role of Industrial Policy

An active industrial policy stance is based on the notion that government has an important role to play in economic development. Industrial policy is aimed at changing the underlying structure of the economy, and any such policy interventions therefore have to be carefully considered.

South Africa has a long history of industrial policy. Prior to 1994, South Africa adopted an interventionist approach aimed at protecting its industries. In contrast, the Growth, Employment and Redistribution (GEAR) plan, which was conceived in 1996, shortly after the democratic transition (effectively replacing the Reconstruction and Development programme (RDP)), was a market-oriented plan (based on what was then termed the "Washington Consensus"). Its basic features were fiscal deficit reduction through expenditure restraint, tight monetary policy and rapid trade liberalisation. In the wake of GEAR, the Accelerated and Shared Growth Initiative – South Africa (ASGISA) was launched with the ambitious goal of accelerating economic growth that would halve poverty and unemployment by 2014. It became clear that factions within the governing alliance were again becoming increasingly discontented about the lack of progress in implementing the decisions of the African National Congress' (ANC) 2007 Polokwane assembly, which resulted in a change in leadership of the ANC and the country.

Since Polokwane and the development of a commitment to the establishment of a developmental state as broad policy goal, major changes have taken place in government, with a sharpening in emphasis on job creation as the principal economic objective. A clear signal in this regard was the creation of a new ministry and government department, Economic Development, and the appointment of Ebrahim Patel, a well-known trade unionist, as minister. A re-allocation of functions was also brought about among the economic ministries.

Time will tell how the division of responsibilities with respect to industrial policy will impact on the effectiveness of policy-making. However, the Minister of Economic Development is responsible for a new overall development strategy appearing on the policy agenda. In October 2010 the cabinet endorsed the New Growth Path (NGP) "that will place employment at the centre of government economic policy".[5] Again, an ambitious target has been accepted of creating - mainly in the private sector – 5 million jobs by 2020, reducing unemployment from 25 per cent to 15 per cent. In achieving this target, five challenges have been identified that need to be addressed, including, *inter alia*, economic concentration and price collusion in key parts of the economy. In order to address these challenges, government aims to unlock employment potential in six key sectors and activities (which will not be discussed here). In addition, the National Industrial Policy

[4] Ibid
[5] Cabinet Statement on the New Growth Path, 26 October. Available at: http://allafrica.com/stories/printable/2010 10260 682.html. Accessed on 22 February 2015.

Framework (NIPF) was introduced in 2007 as a specific sector-oriented policy aimed at supporting the ASGISA strategy. It is not a blueprint of government intervention in support of industrial development, but, as the name indicates, is a framework document that sets the parameters for successive Industrial Policy Action Plans (IPAP).[6]

Importantly, industrial policy has been accounted for in the Competition Act, by way of public interest considerations. Two recent excessive pricing cases further highlight the respective roles of industrial and competition policy and their interplay. This refers specifically to the need of competition and industrial policymakers to address highly concentrated upstream capital-intensive industries and their ability to price at IPP.

4 IPP and excessive pricing

A criticism of IPP is that it does not relate the price of the good to the production cost and the two may therefore differ substantially. If such a price is found to bear no relation to costs and is to the detriment of consumer welfare, the firm in question may be found guilty of excessive pricing under Section 8(a) of the Act, which is defined as follows:

It is prohibited for a dominant firm to –

> *(a) charge an excessive price to the detriment of consumers.*

In this context, an excessive price is defined as:

A price for a good or service which –

> *(aa) bears no reasonable relation to the economic value of that good or service; and*
>
> *(bb) is higher than the value referred to in subparagraph (aa).*

Du Plessis and Blignaut (2009) state that IPP can be an efficient pricing policy due to its consideration of opportunity costs and demand and supply factors. However, under the following circumstances[7], IPP may pose a competition concern:

- High import costs;
- Consumers are vulnerable to high prices;
- There are high and incontestable barriers to entry;
- Demand factors do not support high prices; and
- Profit margins are not the result of risk-taking and innovation.

[6] Republic of South Africa. Department of Trade and Industry. 2015. *Industrial Development.* Available at: http://www.thedti.gov.za/industrial_development/industrial_development.jsp. Accessed on 19 February 2015.

[7] Du Plessis, L. & Blignaut, L. 2009. Staying safe – dominant firms' pricing decisions in industries where high prices do not attract entry. *Third Annual Competition Commission, Competition Tribunal and Mandela Institute Conference on Competition Law, Economics and Policy in South Africa.*

Since there is no link between IPP prices and economic value, each excessive pricing case needs to be assessed on its own merits. Adopting a uniform test is problematic, since the market-specific factors (as listed above) are important considerations to take into account. Many of these factors were present in the Sasol polymers case and the IPP price was substantially higher than the cost of production, given that Sasol is one of the world's lowest cost producers of propylene. In addition, Sasol's dominant position and significant entry barriers had the effect of generating an uncompetitive price for propylene and hence polypropylene.

According to Murgatroyd and Baker (2011) the presence of IPP does not in itself constitute excessive pricing and there are certain factors from economic theory and excessive pricing jurisprudence that show when IPP may reflect excessive pricing. Accordingly, "it is necessary to understand why IPP has resulted, and specifically whether it has occurred purely as a result of competitive market conditions or from a restriction in output below that which would occur under competitive conditions."[8] In order to gain more insights into the reason for implementing an IPP policy, the competition authority will therefore have to undergo a thorough analysis of the industry as well as appropriate empirical analysis.[9] If it possible to properly perform this analysis, it will provide insights into the competitive pressures (if any) in the market. A lack of competition may then indicate the possibility of excessive prices in the market.[10]

In order to inform the debate regarding the interplay between competition policy and industrial policy w.r.t. addressing IPP in upstream markets, the following section will discuss the Mittal and Sasol excessive pricing cases in more detail. The conflicting outcomes of these cases illustrate the inability of competition policy to fully address historic pricing power and imbalances, due to the industrial structure in a sector.

5 Excessive pricing – Mittal and Sasol

Excessive pricing is regarded as one of the most harmful contraventions of competition policy, because of its unambiguously damaging impact on consumers.[11] Therefore, as Williams (2007[12]) states, "the prosecution of excessive pricing might be viewed as the 'purest' of competition policy offences. Indeed, the prevention of monopoly pricing is one of the key features of competition policy." However, it is very seldom enforced by competition authorities due to the uncertainty regarding the appropriate tests to be employed and the consequent high probability of making a Type I error (false conviction).[13]

[8] Murgatroyd, R. & Baker, S. 2011. Does import parity pricing constitute evidence of excessive pricing and what are the consequences of attempting to remedy it? *Journal of Economic and Financial Sciences: Special Issue 1*, 4:167-182.
[9] Ibid
[10] Ibid
[11] Willams, M. 2007. Excessive pricing in *The Pros and Cons of High Prices* Stockholm: Konkurrensverket - Swedish Competition Authority. Chapter 6, 126-153.
[12] Ibid
[13] Motta, M. & De Streel, A. 2007. Excessive Pricing in Competition Law: Never Say Never? in *The Pros and Cons of High Prices*, Stockholm: Konkurrensverket - Swedish Competition Authority. Chapter 2, 14-46.

5.1 Harmony Gold and Durban Roodepoort Deep's (DRD) excessive pricing complaint against Mittal Steel SA (Mittal)[14]

The first notable excessive pricing case brought before the Tribunal was between Harmony Gold and Durban Roodepoort Deep against Mittal, regarding the pricing of flat steel. Mittal enjoyed dominance in this sector, which resulted from its many years of state support (prior to its privatisation in 1989). Mittal effectively became an entrenched dominant firm, which created significant entry barriers that precluded other firms from entering this market.[15] The complaint stated that Mittal's practice of pricing at import parity levels was excessive under Section 8(a), given that they were a net exporter and produced steel at a low cost.[16]

A structural two-step approach allowed the Tribunal to determine whether the market structure would enable Mittal to ask excessive prices and, if so, whether Mittal did indeed abuse their dominant position.[17] During the deliberation process, it was noted that Mittal limited their supply to local firms by diverting their excess steel production into international markets through an exclusive agreement with Macsteel International Holdings, which had the effect of driving up the domestic price.[18] It was also shown that the market structure gave rise to a price level that was higher than the level expected in a competitive market.[19] In this case, the Tribunal placed emphasis on the pricing practices of Mittal and the resultant impact on the downstream manufacturing industry. Mittal's history of state support also led the Tribunal to find that Mittal has an obligation to provide support to the consumers of the intermediate products.[20] Following the structural analysis, it was determined that Mittal did indeed charge an excessive price for flat steel products in the domestic market.

Following Mittal's appeal, the CAC overruled the Tribunal's decision of excessive pricing due to the lack of proper empirical analysis. More specifically, the CAC stated that the Tribunal did not consider the actual wording of the Act and was bound to produce a monetary value for prices and economic value.

5.1.1 Lessons from the Mittal case

The important lessons from the Mittal case follow from the CAC's judgement[21], which specified that an excessive price must be stated as a monetary value. According to the CAC, the Tribunal's failure to include a quantitative analysis went against the wording of Section 8(a), namely the

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[14] Harmony Gold Mining Limited,Durban Roodepoort Deep Limited vs Mittal Steel South Africa Limited,Macsteel International Holdings BV – Case no 13/CR/Feb04

[15] Competition Commission of South Africa. 2009. *Unleashing Rivalry: Ten years of enforcement by the South African competition authorities.*

[16] Ibid

[17] Ibid

[18] Ibid

[19] Ibid

[20] Njisane, Y. & Buthelezi, Z. 2014. The incorporation of the public interest test in the assessment of prohibited conduct: a juggling act? *Eighth Annual Conference on Competition Law, Economics & Policy*, 4-5 September, 2014.

[21] Mittal Steel South Africa Limited,Macsteel International BV,Macsteel Holdings (Pty) Limited vs Harmony Gold Mining Company Limited,Durban Roodepoort Deep Limited – Case no 70/CAC/Apr07

reference to price and economic value. Subsequently, the CAC stated that an analysis of excessive pricing must include the following[22]:

1. the determination of the actual price charged;
2. the economic value of the good or service must be ascertained;
3. if the actual price exceeds the economic value, it must be determined whether the difference between them is unreasonable; and if so,
4. it must be determined if the charging of the excessive price is to the detriment of consumers.

5.2 Excessive pricing complaint against Sasol Chemical Industries (Sasol)[23]

5.2.1 Background

The South African economy is heavily skewed towards upstream capital-intensive industries like Sasol. Their monopoly position in the market allows such dominant players to extract rents through the pricing of inputs in the downstream labour-absorbing markets.[24] In Sasol's case, their history of state support, as part of the industrial policy at that time, afforded them a dominant position in the polymers market, an essential input for plastic converters in producing plastic goods.[25] The lack of proper competition in the upstream market means that downstream firms are price-takers, while Sasol could effectively set the price of propylene and polypropylene at the highest possible price, which in this case is the Import Parity Price (IPP).[26]

As a result of the market situation described above, the Department of Trade and Industry (DTI) requested the Competition Commission to launch an investigation into the pricing of polymer chemicals.[27] The investigation eventually turned into South Africa's second prominent case of excessive pricing, namely the case against Sasol Chemical Industries (Sasol or SCI) for purified propylene and polypropylene. In essence, they were accused of charging an exorbitant price relative to their low cost of production of the goods in question.

Over the period investigated, Sasol produced large volumes for export, but charged domestic firms at IPP.[28] The practice of pricing at IPP has been scrutinised since the Mittal case and has regained its prominence in policy circles following the Sasol judgement. In 2002, Sasol's pricing

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[22] Du Plessis, L. & Blignaut, L. 2009. Staying safe – dominant firms' pricing decisions in industries where high prices do not attract entry. *Third Annual Competition Commission, Competition Tribunal and Mandela Institute Conference on Competition Law, Economics and Policy in South Africa.*
[23] Competition Commission vs Sasol Chemical Industries Ltd and Safripol (Pty) Ltd – Case no 011502
[24] Roberts, S. & Mondliwa, P. 2014. Excessive pricing and industrial development: the recent Competition Tribunal finding against Sasol Chemical Industries. *Centre for Competition, Regulation and Economic Development: University of Johannesburg.*
[25] Ibid
[26] Ibid
[27] Ibid
[28] Ibid

agreement with downstream companies changed to an IPP agreement. Under IPP, domestic prices are set at the world price (in Rand terms), which includes transportation and insurance fees, taxes and other costs that the buyer would have to incur if importing the good in question. IPP thus represents a ceiling price at which a good can be sold in the domestic market. If the product is sold at a higher price, the domestic consumer would be better off importing the good.

In addition to pricing at IPP levels, Sasol also enjoyed a special cost advantage. Their history of state support has enabled them to become one of the lowest cost producers of propylene and polypropylene in the world. This extensive support also disincentivised any risk-taking or development in Sasol's polymers division.[29] If a firm were to take risks in attaining its high profit levels, excessive prices may be justified on the basis of *ex ante* risk on the firms' behalf, given that one must be compensated to offset the uncertainty involved with risky business endeavours.[30] The issues regarding Sasol's lack of risk-taking and their history of state support featured prominently in the analyses and supplemented the quantitative tests offered by both parties.

5.2.2 Tests used in the Sasol excessive pricing analysis[31]

The definition of excessive pricing in South Africa's Competition Act under Section 8(a) follows closely from that of the United Brands case under the European Court of Justice's (ECJ) jurisdiction.[32] Following this definition and the CAC's four-step test set out in the Mittal judgement, the Commission conducted several empirical tests to ascertain a monetary amount for the alleged excessive prices charged by Sasol. Several benchmarks were offered by both parties. The most relevant were (i) the price-cost test, (ii) the export price comparison, (iii) prices charged by other firms in other geographic markets and the so-called (i) "*Mittal* 1" approach. It should be noted that feedstock propylene is a by-product of Sasol's fuel production and is used as an input into the production of purified propylene, which, in turn, is used as an input into the production of polypropylene.[33]

5.2.2.1 Price-cost test

(i) Purified propylene

Although the price-cost test formed the basis of the Tribunal's ultimate finding, there was significant discourse regarding the appropriate prices and costs to be used. The expert witnesses agreed that economic costs include variable costs, fixed costs, depreciation, and a return on capital. However, they differed on the composition of these categories. After adjustments, the mark-ups over actual costs during the complaint period were in the range of 39.9–41.5% for Tier

[29] Ibid
[30] Lewis, D. 2008. *Chilling Competition* in Hawk, B ed. International Antitrust Law & Policy: Fordham Competition Law
[31] Competition Tribunal of South Africa. 2014. Case No: 48/CR/Aug10. Non-Confidential Decision.
[32] Judgment of the Court of 14 February 1978. - United Brands Company and United Brands Continentaal BV v Commission of the European Communities. - Chiquita Bananas. - Case 27/76.
[33] Competition Tribunal of South Africa. 2014. Case No: 48/CR/Aug10. Non-Confidential Decision.

2 prices, between 25.1–26.5% for Tier 1 and between 31.5–33% for an average of Tier 1 and Tier 2 prices.[34]

(ii) Polypropylene

Following the Tribunal's finding that Sasol charged an excessive price for purified propylene, they illustrate the impact on polypropylene using (i) a conservative approach (purified propylene is 20% excessive) and (ii) a more realistic approach (purified propylene 30% is excessive). The Tribunal used the actual purified propylene prices in the calculation of polypropylene price-cost mark-up; therefore no adjustments were made to the actual feedstock propylene costs. The Tribunal ultimately found the polypropylene mark-up to be in the range of 17.6–25.4% when measured conservatively and within the range of 26.9–36.5% when evaluated on a more realistic basis.

5.2.2.2 Export price comparison

(i) Purified propylene

This benchmark compares the domestic purified propylene price with its export price, which serves as a floor price to which domestic prices will tend in a competitive market with over-supply. In this case, there are only export prices for polypropylene, not for purified propylene. The Commission used the export price of polypropylene to impute an economic value for purified propylene via Safripol's[35] Supply Agreement. The local polypropylene prices are substituted with Sasol's export prices. However, the Tribunal did not regard this imputed purified propylene export price as an appropriate benchmark.

(ii) Polypropylene

In the CAC's Mittal judgement, it is stated that prices may be unreasonable if there is a consistent differentiation between prices charged in the export and domestic market. Domestic prices will always be higher than export prices. If the domestic price is lower than the export price, the firm would rather export their goods. Consequently, the domestic prices may be unreasonable if there is an active strategy to expand the production of the lower priced exported goods. It was ultimately found that Sasol's domestic polypropylene prices were 32% higher than export prices to China. A further comparison was conducted with the average export netback price for deep sea exports, which found Sasol's domestic prices to be, on average, 23% higher.

5.2.2.3 Prices charged by other firms in other geographic markets

(i) Purified propylene

An additional benchmark is to compare Sasol's price-cost mark-up with similar international firms. From the Mittal case, the CAC proposed comparing firms that have similar cost-structures. The

[34] Tier 1 and Tier 2 refer to different prices charged to Safripol by Sasol. Tier 2 is the higher of the two prices.
[35] Safripol (Pty) Ltd is Sasol's one domestic customer of purified propylene and a competitor of Sasol at the polypropylene level.

Commission followed this approach, while Sasol thought this to be an irrelevant point. The Tribunal agreed with the Commission in comparing *like with like*. However, there are many difficulties in selecting an appropriate comparator for purified propylene prices. Asian firms tend to have special discounts which are difficult to incorporate. In addition, their pricing practices are not transparent enough. The United States (US) and Europe were also not deemed to be appropriate comparators, since they have higher cost-structures than Sasol.

(ii) Polypropylene

Regarding polypropylene pricing, the Tribunal evaluated the US and Europe as potential comparators. However, it is important to note that Sasol has access to cheap feedstock propylene. In the case of the US, Sasol did not take into account that the US is not a low-cost producer like themselves. A variety of reported prices also made it difficult to establish appropriate domestic US prices. Similarly, European firms also do not have low costs. However, an adjustment was made in order to compare Sasol polypropylene prices to Western European polypropylene prices. Ultimately, it was found that Sasol's prices were 41% and 47% higher for homopolymer and raffia grade when compared to discounted Western European prices that were calculated using feedstock costs similar to Sasol's.

5.2.2.4 "Mittal 1" test

Sasol offered an additional approach, whereby they postulated a hypothetical market with notional competitors and their respective prices and costs. This approach follows from the CAC's conceptual framework in the Mittal case. However, the Tribunal did not perceive this to be a valid test. Although this hypothetical market scenario evoked considerable debate, the Tribunal was not persuaded by either party's arguments and disregarded this test in its final judgement.

5.2.3 The Competition Tribunal's judgement

On June 5, 2014, the Tribunal ruled that Sasol was guilty of contravening Section 8(a) of the Competition Act. From the methods listed above, it is clear that the Tribunal arrived at their finding using a "preponderance of evidence" approach, namely by analysing several available tests and benchmarks. This adheres to Motta and De Streel's (2007) approach, namely that the analysis should not be limited to prices and costs, but needs to be supplemented by a "deep" investigation of the market and possible reasons why prices may be above the competitive level.[36] In this vein, several country-specific factors, which are not included in the actual excessive pricing clause, featured prominently throughout the case and formed an important part of the Tribunal's final judgement. For example, Sasol's history of state support, lack of risk-taking and innovation and the highly concentrated upstream industry, which allowed them to price at IPP, formed part of the analyses. This was done to supplement the quantitative tests that were proposed by the CAC. The finding has since been appealed by Sasol and will be subject to review by the CAC.

[36] Motta, M. & De Streel, A. 2007. Excessive Pricing in Competition Law: Never Say Never? in *The Pros and Cons of High Prices*, Stockholm: Konkurrensverket - Swedish Competition Authority. Chapter 2, 14-46.

5.3 How were the Mittal and Sasol cases handled differently?

The Mittal and Sasol cases both addressed the issue of excessive pricing under IPP that resulted from a history of state support, driven by the industrial policy framework of that time. A structural approach was followed by the Tribunal in the Mittal case, but was overturned by the CAC due to a lack of proper empirical analysis. In the Sasol case, the analyses followed the recommendation of the CAC and produced actual values for price and economic value of the goods in question. However, from the different outcomes of the respective cases, it is evident that the Tribunal and the CAC have conflicting views regarding excessive pricing (the CAC is at the time of writing still considering the Sasol case). Their differing interpretations of the same section of the Act (as evidenced in the Mittal case), brings into question the appropriateness of using competition policy to address the issue of historical dominance and the resultant pricing power. The following section will discuss this in more detail.

6 Questions regarding the usefulness of the South African excessive pricing clause to address pricing power

6.1 Complexity of excessive pricing tests

One of the main contentions against enforcing excessive pricing regulation is the complexity involved in determining the appropriate tests to use and the actual calculations involved in conducting these tests, especially if the firm in question has group costs or is part of a multi-market firm, such as Sasol.[37] Different methods were applied in Mittal and Sasol. In Mittal, a structural approach was used to determine whether the structure of the market was conducive to excessive pricing. Following the CAC's condemnation of this approach and the proposal of their subsequent four-step test, the Sasol case saw the use of many different benchmarks by both parties. However, there were significant difficulties in arriving at the final figures. For example, this excerpt from the Tribunal's judgement summarises the complicated nature of conducting price-cost tests in excessive pricing cases:

> *"We accept that there normally are complexities to performing a price-cost test and this case was certainly no exception. Whilst the expert witness agreed that in principle economic costs include variable costs, fixed costs, depreciation, and a return on capital, they differed on what costs to include in each of these categories. Roberts and Wainer for the Commission selected approaches that had the effect of increasing as far as possible the price-cost markups and Padilla and Harman, on the other hand, selected approaches that chiselled away as far as possible at the price-cost markups."*[38]

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[37] Organisation for Economic Co-Operation and Development. 2011. Excessive Prices. *OECD Policy Roundtables.*
[38] Competition Tribunal of South Africa. 2014. Case No: 48/CR/Aug10. Non-Confidential Decision.

6.2 Problems with the wording of Section 8(a)

In developing the Competition Act, several parties such as the DTI, labour organisations, small businesses and big business, wanted to promote their own interests.[39] According to David Lewis, big business "saw itself as the likely target of the pending new competition law and which was thus prepared to commit its resources to defending what it viewed as its essential interests."[40] This stems from the theory that when markets are poorly equipped to effectively discipline dominant firms, an over-enforcement strategy is more appropriate, which will lead to a "false positive".[41] Big business consequently argued for the incorporation of international excessive pricing precedence into the Act, which provided them with a clearer definition of excessive pricing.[42] The high degree of specificity in the wording of the Act allowed dominant firms to be better informed regarding competition concerns that may arise from their pricing practices.[43] In contrast, a vague definition would effectively "chill" investment, which would be detrimental to economic growth under the GEAR policy of the time.

According to Sylvester (2013), the excessive pricing definition proposed by big business was included at a late stage in the process of writing the Act. The DTI also did not actively contest this definition.[44] Following the consequent inception of the Competition Act, Section 8(a) would state the following[45]:

It is prohibited for a dominant firm to –

(a) charge an excessive price to the detriment of consumers.

In this context, an excessive price is defined as:

A price for a good or service which –

(aa) bears no reasonable relation to the economic value of that good or service; and

(bb) is higher than the value referred to in subparagraph (aa).

As was the intention of big business, this clause draws from international case precedent, specifically the ECJ's United Brands case, as can be seen from the excerpt below:

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[39] Sylvester, A. 2013. Excessive prices legislation in developing markets: Some problems that arise when importing the law from developed jurisdictions. Master's dissertation: *University of KwaZulu-Natal, School of Accounting, Economics and Finance College of Law and Management Studies.* (This source provides a detailed account of the evolution of excessive pricing in the South African Competition Act).
[40] Lewis, D. 2012. *Thieves at the Dinner Table: Enforcing the Competition Act: A Personal Account.* Johannesburg; Jacana Media.
[41] Lewis, D. 2008. *Chilling Competition* in Hawk, B ed. International Antitrust Law & Policy: Fordham Competition Law
[42] Sylvester, A. 2013. Excessive prices legislation in developing markets: Some problems that arise when importing the law from developed jurisdictions. Master's dissertation: *University of KwaZulu-Natal, School of Accounting, Economics and Finance College of Law and Management Studies.*
[43] Ibid
[44] Ibid
[45] South African Competition Act 89 of 1998.

"Charging a price which is excessive because it has no reasonable relation to the economic value of the product supplied may be an abuse of a dominant position within the meaning of subparagraph (a) of Article 86"[46]

Importantly, the South African clause contains the same normative statements such as 'excessive' and 'reasonable relation', which leaves the interpretation open to value judgements. In addition, the term 'economic value' is also uncertain, which allows for several ways to quantify (or manipulate) this value.[47] Consequently, Section 8(a) leaves a lot of room for (mis)interpretation and does not provide a clear benchmark for assessing excessive prices.[48] Effectively, the onus lies on the parties to determine the economic value of the good or service, giving rise to a wide variety of definitions supplied by opposing parties. Most notably, the excessive pricing clause makes no allowance for country-specific factors and seems to merely adopt the wording of the United Brands case.[49]

6.3 Problems with adopting a developed country's excessive pricing definition

From the Mittal and Sasol cases, it is clear that the South African excessive pricing experience is unique compared to the international jurisprudence. According to Sylvester (2013), "… *[t]his is because the ability for a firm to sustainably charge an excessive price is inextricably linked to the market in which it is operating, and a small open market geographically far from other markets with a history of government intervention raises very different issues to large developed markets.*"

As discussed earlier, South Africa's current industrial policy framework places emphasis on development objectives, mainly through increased employment. It is important to keep this in mind when assessing the appropriateness of the current South African excessive pricing clause, because, as Fox and Gal (2014) succinctly state: "development affects goals."[50] In other words, developed countries that already preside over well-functioning markets have different competition goals than developing countries.

It is also not a case of extending the time-frame for developing countries to reach the same outcomes as in developed jurisdictions.[51] The developmental requirements of a developing economy needs competition legislation that is designed to take into account its idiosyncrasies.[52]

[46] Judgment of the Court of 14 February 1978. - United Brands Company and United Brands Continentaal BV v Commission of the European Communities. - Chiquita Bananas. - Case 27/76.
[47] Competition Commission of South Africa. 2003. *Final Report to the Department of Trade and Industry on Import Parity Pricing.*
[48] Sylvester, A. 2013. Excessive prices legislation in developing markets: Some problems that arise when importing the law from developed jurisdictions. Master's dissertation: *University of KwaZulu-Natal, School of Accounting, Economics and Finance College of Law and Management Studies.*
[49] Ibid
[50] Fox, E.M. & Gal, M.S. 2014. Drafting Competition Law for Developing Jurisdictions: Learning from Experience. New York University Law and Economics Working Papers.
[51] Fox, E.M. Antitrust in No One's World. *Antitrust*, 27(1):73-74.
[52] Fox, E.M. & Gal, M.S. 2014. Drafting Competition Law for Developing Jurisdictions: Learning from Experience. *New York University Law and Economics Working Papers.*

Given the uniqueness of South Africa's experience with excessive pricing, it may therefore be inappropriate to adopt a developed country's excessive pricing definition. As stated by Fox (2007): "Developing countries deserve an antitrust law that fits the facts of their markets and responds to their conditions and needs."[53]

Furthermore, although the most recent excessive pricing pronouncements by the ECJ have followed the United Brands test, there has been little consistency overall regarding excessive pricing cases in Europe. According to Du Plessis and Blignaut (2009), "[t]he ECJ even seemed to abandon the United Brands two-stage test, in favour of a more "integrated" approach based on various categories of benchmarking."[54] There is thus a clear lack of consistency in the rulings of the ECJ as well as isolated cases where different methodologies have been applied.[55] Therefore, even in developed jurisdictions, it is clear that excessive pricing is difficult to assess and needs to be done on a case-by-case basis. South African competition authorities therefore have to be careful to adopt a definition of excessive pricing which is too narrow and does not allow for its unique market characteristics to be considered.[56]

6.4 Conclusion

In summary, the current excessive pricing clause in Section 8(a) of the Act has been interpreted differently by the Tribunal and the CAC, which may imply that the excessive pricing clause is not adequately specified. As a result, it gives rise to complex calculations which attempt to quantify the alleged excessiveness, although it leaves substantial room for arbitrary value judgements which may bias the results. Furthermore, Section 8(a) is adopted from a developed jurisdiction, which does not take into account South Africa's idiosyncrasies. In light of the problems faced by competition authorities in addressing concentrated upstream markets through *ex post* competition law and unclear excessive pricing legislation, it is necessary to investigate possible alternative policy measures that may be more suited to the task.

7 Options available to address highly concentrated markets and the resultant use of IPP

Post-1994 industrial policy focused on harnessing South Africa's natural resource advantage and to carry this advantage over to downstream value-added industries, in order to grow the economy. According to the NIPF, cost-effective inputs are essential in the industrialisation process. However, there is currently a problem in the industrialisation process which stems from the

[53] Fox, E.M. 2007. Antitrust, economic development and poverty: The other path. *New York University Law and Economics Working Papers, nr 102,* 1-27.

[54] Du Plessis, L. & Blignaut, L. 2009. Staying safe – dominant firms' pricing decisions in industries where high prices do not attract entry. *Third Annual Competition Commission, Competition Tribunal and Mandela Institute Conference on Competition Law, Economics and Policy in South Africa.*

[55] Ibid

[56] Sylvester, A. 2013. Excessive prices legislation in developing markets: Some problems that arise when importing the law from developed jurisdictions. Master's dissertation: *University of KwaZulu-Natal, School of Accounting, Economics and Finance College of Law and Management Studies.*

uncompetitive wielding of market power in several concentrated input markets.[57] The post-apartheid period has so far seen horizontal unbundling of conglomerates, only to be replaced by vertical re-bundling, which compounds the problem regarding high (and in some cases rising) concentration in many sectors.[58]

Sasol's dominance allowed it to change its pricing policy in 2002, which had a definite impact on the downstream plastics industry. A competitive price for polypropylene led to 6% average annual growth between 1994 and 2002. However, with a subsequent change to IPP, this industry has seen a 1% average annual contraction, coupled with a loss of 13 000 direct jobs.[59] Such a downturn in activity and employment places downward pressure on the margins of the plastic converters, which discourages them from pursuing research and development agendas.[60] This is especially detrimental to the manufacturing sector, which is vitally important in creating inclusive growth, since manufacturing has a multiplier effect.[61] As a result, a vicious cycle of underdevelopment, contraction and further job losses may manifest. This threat has motivated industrial policymakers to pursue those upstream firms with significant market power, particularly to address their practice of pricing at IPP.[62] Although there is consensus regarding the problems with implementing IPP, the appropriate method to address this subject is less clear. The following subsections will discuss the situations under which IPP may be regarded as excessive, as well as the government's and competition authorities' view on addressing this issue.

7.1 The government's view on addressing IPP

Following the Tribunal's finding of excessive pricing against Sasol, there has been increased focus on competition policy as a tool to address the pricing practices of dominant firms. The fact that IPP resulted in excessive prices for important inputs in downstream markets prompted many critics to advocate for the competition authorities to facilitate the removal of IPP as a pricing option for dominant firms.[63]

Although the Commission is functionally independent, several commentators have warned that government utilises it as a tool to foster development objectives.[64] Consequently, in a colloquium on beneficiation, Davies advocated for the abolishment of IPP pricing and requested increased cooperation from dominant firms such as Mittal and Sasol, otherwise they will be forced to return to the competition courts. This relates to the government's current focus on beneficiation, which is effectively being hamstrung by the high prices of input products charged by dominant firms in

[57] Republic of South Africa. Department of Trade and Industry. 2014. *National Industrial Policy Framework.*
[58] Ibid
[59] Roberts, S. & Mondliwa, P. 2014. Excessive pricing and industrial development: the recent Competition Tribunal finding against Sasol Chemical Industries. *Centre for Competition, Regulation and Economic Development: University of Johannesburg.*
[60] Ibid
[61] Ibid
[62] Republic of South Africa. Department of Trade and Industry. 2014. *National Industrial Policy Framework.*
[63] Ensor, L. 2014. Davies sounds warning to ArcelorMittal, Sasol. *Business Day Live*, 3 September 2014. Available at: http://www.bdlive.co.za/business/2014/09/03/davies-sounds-warning-to-arcelormittal-sasol. Accessed on 10 February 2015.
[64] Ibid

important industries. Davies has proposed a 10% price cut in Mittal's steel and platinum prices and a 10–15% cut in Sasol's polymer prices.[65] This call for developmental pricing was reiterated by Economic Development Minister, Ebrahim Patel, who is currently drafting amendments to the Competition Act to allow competition authorities more scope to pursue the pricing practices of dominant firms.[66]

7.2 Is competition policy the best tool to address the IPP 'loophole'?

The Competition Commissioner, Tembinkosi Bonakele, stated that competition policy may not be the most appropriate tool to address loopholes in the implementation of industrial policy.[67] Since the initial investigation into the chemicals industry, it has taken seven years to arrive at a verdict regarding Sasol's contravention of Section 8(a). The "slow and litigious" nature of competition cases may therefore be a "delayed remedy" in addressing industrial policy concerns regarding pricing, especially if the appeals process also takes a number of years to complete.[68]

A coordinated approach is needed, whereby industrial policy and competition policy consult on matters relating to uncompetitive pricing practices in order to achieve pro-competitive outcomes. According to Bonakele, possible alternatives to competition policy could include (i) regulation as stated in IPAP6, (ii) regulation by the National Energy Regulator of South Africa (NERSA) or the Department of Energy (DOE) through its regulation on fuel prices and (iii) mining licence conditions that state that minerals and derivative products should be sold at competitive market prices.[69]

It should be noted that competition authorities are cautious of playing the role of price regulator. Industry regulators typically have much more in-depth knowledge to determine the appropriate price. In addition, the price regulator will have to provide the regulated firms with predictable prices in order to foster investment. Not to mention the extensive data-gathering process needed to set prices and the resources needed to provide adequate monitoring of the firms.[70]

Lewis (2012) reiterates this point by stating that it is naïve to think that one or two sentences in a competition statute is a sound basis for turning competition authorities into price regulators. The process is practically difficult and should fall within the ambit of specialised price-regulating institutions or industry regulators.[71] In addition, the Centre for Competition, Regulation and Economic Development (CCRED) advocates that setting rules on pricing and market behaviour

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[65] Ibid
[66] Paton, C. 2014. Patel reworks Competition Act against excessive pricing. *Business Day Live*, 11 August 2014. Available at: http://www.bdlive.co.za/business/2014/08/11/patel-reworks-competition-act-against-excessive-pricing. Accessed on 10 February 2015.
[67] Ibid
[68] Bonakele, T. 2014. *Import Parity Pricing and Competition Policy*. Speech before Parliament, 26 August 2014.
[69] Ibid
[70] Organisation for Economic Co-Operation and Development. 2011. Excessive Prices. *OECD Policy Roundtables.*
[71] Lewis, D. 2012. *Thieves at the Dinner Table: Enforcing the Competition Act: A Personal Account.* Johannesburg; Jacana Media.

is a better approach than to address the problem through competition policy, which will always be retrospective in its analysis.[72]

7.3 Concluding remarks and comments on Sasol's appeal

If there is persistent market failure created by historic factors and interventionist industrial policy, then *ex post* competition law might not be the perfect instrument. This is illustrated by the contradiction in the outcomes from the Mittal and Sasol cases. This paper has identified certain problems associated with identifying excessive prices, as discussed above, which may have contributed to these different outcomes. As a result, using competition policy to address the issue of high market concentration in capital-intensive upstream markets may not be ideal, especially if it requires competition authorities to act as a price regulator, which does not fall within their policy domain. Consequently, industrial policy might be better suited to address such deeply engrained historical manifestations of market and pricing power.

This holds some significance for the CAC's ruling on Sasol's appeal. The CAC previously overruled the Tribunal's finding of excessive pricing in the Mittal case and referred it back to the Tribunal with instructions to calculate actual monetary prices and costs. However, the case was privately settled out of court, without the proper analysis being completed. Thus, the outcome of the Sasol appeal holds great significance for excessive pricing jurisprudence in South Africa (and also worldwide).

On the issue of the CAC's decision in Mittal, Judge Dennis Davis stated that the CAC adhered too closely to the definition of excessive pricing under Section 8(a). Regarding the definition of excessive pricing and its interpretation in the Mittal case, Davis stated the following:

> "*But may I just say what it reveals to me is an ambitious piece of legislation. It is not unimportant, because of the nature of the economy from which we come. It is important historically, because how do you bring parastatal corporations which are now private into the discipline of a market when they have these enormous percentages of the market? But, on the other hand, when the legislature has chosen a particular formulation, you've also got to be rather careful not to just cavalierly reject it. So the dilemma that a court faces is a Tribunal decision which is morally correct, probably is economically correct, but is legally wrong.*"[73]

The structural approach followed by the Tribunal was an innovative way of accounting for the idiosyncrasies of the South African economy. However, according to the CAC, its usefulness was brought into question, following their lack of regard for the exact wording of Section 8(a) of the Act. As discussed earlier, the very precise definition as adopted from the United Brands case was drafted into the Competition Act at the behest of big business' interests. In contrast, the DTI's

[72] Makhaya, T. 2014. Let us also look at constraints from dominant firms. *Business Day Live*, 5 August 2014. Available at: http://www.bdlive.co.za/opinion/columnists/2014/08/05/let-us-also-look-at-constraints-from-dominant-firms. Accessed on 15 February 2015.

[73] Davis, D. 2010. *Roundtable discussion with Dennis Davis* in Hawk, B ed. International Antitrust Law & Policy: Fordham Competition Law

advocacy of a broader, country-specific definition was not as prominent in the final Competition Act.[74] Importantly, if it is eventually found that there is indeed too narrow an interpretation of the excessive pricing clause, this may imply that the CAC was incorrect when they overruled the Tribunal's decision in the Mittal case. Therefore, it will be interesting to see if the CAC contradicts themselves when they rule on the Sasol appeal.

8 Conclusion

Competition policy has a very important role in the South African economy, namely promoting and maintaining competition in South Africa, while being cognisant of the concentrated market structure which resulted from interventionist policies of the previous political regime. Industrial policy is responsible for changing the underlying structure of the economy to aid in development and features in the Competition Act 89 of 1998, mainly under public interest considerations. The interplay between competition policy and industrial policy has featured prominently in the two recent excessive pricing cases of Mittal and Sasol. In these cases, it was seen that highly concentrated capital-intensive upstream firms had a detrimental impact on downstream labour-absorbing industries. In addressing the alleged excessive prices in both these cases, the Tribunal and the CAC had differing interpretations of the clause specified in Section 8(a) of the Act.

The uncertainty regarding assessing excessive pricing raises the issue of whether competition policy is the appropriate instrument to address market failures in highly concentrated upstream sectors of the economy. This paper argued that there are several unresolved issues w.r.t. the current excessive pricing clause, namely the complex calculations it necessitates, the arbitrary and subjective terms used in the clause and the inappropriateness of adopting a developed jurisdiction's excessive pricing definition. The time-consuming nature of competition cases may also not be the most effective way of addressing structural concerns. In addition, competition authorities have explicitly argued against assuming the role of price regulator, as they are not as well-informed or well-equipped as sector regulators to perform this function properly. This paper therefore argues that persistent market failures in highly concentrated sectors of the South African economy may be better addressed through well-designed and targeted industrial policy.

[74] Sylvester, A. 2013. Excessive prices legislation in developing markets: Some problems that arise when importing the law from developed jurisdictions. Master's dissertation: *University of KwaZulu-Natal, School of Accounting, Economics and Finance College of Law and Management Studies.*