One of the goals of the Competition Act, 1998 (Act No 89 of 1998), (the Competition Act) is “to provide consumers with competitive prices and product choices”. In this article, we focus solely on the direct financial benefits to consumers.

We derive conservative estimates of the impact of the Competition Commission’s (the Commission) intervention following the uncovering of the South African cement cartel.

To do this, we estimate the avoided price as a result of the uncovering of the cartel and the avoided duration in years (the avoided duration is the estimated expected future duration of a cartel, using case specific information). We estimate the annual impact on consumers by multiplying the sales of the affected goods by the price increase caused by agreement. We estimate consumer savings, by multiplying the annual impact by the number of years we believe the cartel may have remained operational, but for the Commission’s intervention. The Commission initiated an investigation into the cement industry in June 2008, after conducting a scoping study in the markets for...
construction and infrastructure inputs. Subsequently, Pretoria Portland Cement Company Limited (“PPC”), the largest cement producer in South Africa, applied for leniency around August 2009 and agreed to fully cooperate with the Commission by providing information on the cement cartel. Importantly, PPC also agreed to stop sharing detailed sales information through the industry association (Cement and Concrete Institute or C&CI), an important instrument that had been used by the cartel to sustain its operations.

The cartel involved price fixing and market allocation through the allocation of market shares and territories by the main cement producers (PPC, Lafarge, AfriSam and NPC-Cimpor).

How the cartel operated

The cartel members had devised ways of continuing to coordinate their behaviour after the government disbanded an officially sanctioned cartel in 1996. Before 1996, the cartel had been exempt from competition legislation. In anticipation of the disbandment of the cartel in 1996, cement producers agreed in 1995 that each producer would continue to hold a market share they enjoyed during the official cartel period. However, immediately after the cartel was disbanded, a price war ensued, prompting the producers to meet in 1998 and devise ways to bring the market back to “stability”.

This meeting culminated in agreements on market shares, the pricing parameters for different types of cement, the scaling back of marketing and distribution activities with agreed closure of certain depots in certain regions and banning of discounts on higher quality cement.

In order to police the agreement and deal with the cartel problem of cheating, the cement producers devised an elaborate scheme of sharing detailed sales information through the C&CI. The information sharing saw individual firms submitting their monthly sales figures to the association’s auditors according to the geographic region, packaging and transport type, customer type, product characteristics and imports. The data was then aggregated by the auditors, before being disseminated to the cement producers by the C&CI.

Given the high concentration level of the cement industry, firms could use the aggregated data received from the association to monitor their own market share. If there were any deviations from an agreed target, a firm could discern from the data exactly where the deviations came from. Therefore targeted punishment or volume shedding could be undertaken without causing a price war or in any way destabilising the market.

The Commission concluded settlement agreements with AfriSam in November 2011 and Lafarge in March 2012. The two firms also confirmed the existence of the cartel and its modus operandi. The two firms paid settlement fines of approximately R125 million and R149 million, respectively.

The Commission’s investigation

Prior to the 2008 investigation, the Commission had an earlier investigation in which it conducted raids on the premises of PPC and Slagment as early as 2000. PPC and Slagment successfully challenged the raid resulting in the return of the raided documents. It is probable that these documents contained details of the 1998 agreement, and therefore it is likely that the cartel could have been uncovered then but for the legal challenge.

Estimating the avoided price invariably involves comparing the outcomes in a world in which there is a cartel to where there is no cartel. This involves constructing a counterfactual price and comparing it to the observed price. Holding everything constant, the difference between the two is attributable to the intervention. There are various methods to estimate ‘counterfactual’ prices and each differ with respect to their conceptual complexity and underlying assumptions. In this case, we used the during and after approach which basically compares the price during the cartel period with the price in the same market after the cartel period.

To do this, we model the cement price during and after the cartel using a multivariate econometric model that takes into account relevant control variables. These control variables include a set of determinants of the price in the cartel and non-cartel periods such as cost of production, raw materials that go into the production process of cement and variables that account for demand.

In simple terms, the model estimates the cement price at time as a function of the price of coal, limestone, iron ore, energy, oil and construction. The cost shifters are selected based on the inputs that go into the production process of cement. The price index of construction, which measures the construction activity in the economy, is used as an instrument for the demand of cement. Thus, in this model, cement price is determined by cost and demand factors, which resonates with the real world.

In order to estimate the effect of the cartel, we include the dummy variable in the regression equation, which takes a value of ‘1’ during the cartel period and a ‘0’ otherwise. The corresponding coefficient captures the difference of the price between the cartel period and the non-cartel period. It is noted that the accuracy of the estimation, depends on how well the model can explain the observed variation in actual prices in the market.

The regression results based on data from January 2008 to December 2012 show that the price difference between the cartel period and the non-cartel period (i.e. the price overcharge) is 7.5% and is statistically significant at 1%. Statistical significance of 1% simply means that, given the model, the probability of the estimated effect of the cartel on price to have occurred by chance alone is less than 1%.

We also extended the model to account for the global financial crisis of 2008. With this extended model, the price difference between the cartel period and the non-cartel period is 9.7% and statistically significant at 1%. Note, however, where hard core anti-competitive practices involve, for example, price-fixing and market sharing, recent academic evidence by Connor (2009) supports a median overcharge of between 17% to 30%.

Using these estimates of overcharges, the consumer savings as a result of the Commission’s intervention is approximately in the range of R4.5 to R5.8 billion for the period 2010 to 2013. However, had the Commission been successful in its first investigation, the consumers savings would have been approximately in the range of R14.9 to R18.3 billion for the period between 2000 and 2013.
The emphasis on impact assessment has been a steady process at the Commission which has been reinforced in the last few years. Impact assessment in the context of the Commission is defined as any activity that is designed to measure or estimate the effectiveness, costs and benefits or value to society of competition decisions, or the effectiveness or costs and benefits of the competition policy regime as a whole. It is interesting to reflect on the determinants of this process. In my view, there are several main drivers behind this development.

First, one of the strategic goals of the Commission is achieving demonstrable competitive outcomes in the economy. The Commission’s ability to demonstrate the impact it is making is closely associated with prioritisation. Prioritisation is underpinned by decisions regarding high-impact and significance, and as such there is a need to assess and evaluate the effectiveness of these decisions. Social, business and political stakeholders are also insisting on benefits of competition policy enforcement. The Commission is increasingly being required to account for its contribution to transforming the economy and empowerment in response to past and present exclusions and in line with the objectives of competition law in South Africa. Second, through impact assessments the Commission wishes to increase transparency and awareness of its activities and build support for these activities across a wide range of stakeholders. Finally, the Commission hopes to learn from past performance in order to improve the quality of analysis and decision making in the future.

The Commission’s work on impact assessment falls into three distinct categories. First, for selected cases, it involves ex-post evaluation and monitoring. An ex-post evaluation involves the assessment, a few years after a decision has been made, of the actual effects of that individual decision. Since competition decisions require some time to produce their effects, this implies that ex-post evaluations can identify and assess the actual effects they generate. Second, for selected cases, it involves impact estimation assessments which estimate the likely impact of competition decisions on the basis of assumptions. Finally, research is conducted on an ongoing basis into the wider benefits of the activities of competition authorities including factors such as the deterrent effect of competition policy.

In this issue, Siphamandla Mkwanazi and Hariprasad Govinda assess the static consumer benefits resulting from the uncovering of the cement cartel. They estimate (1) the size of the affected turnover; (2) the price increase removed or avoided; and (3) the expected duration of the price effect. The total consumer benefit is the product of these three figures. This method inevitably provides simple and partial estimates of the likely benefits. One of the most important highlights this year will definitely be the Commission’s victory against Sasol. A brief overview of this case is provided in this issue. On 05 June 2014, the Competition Tribunal (the Tribunal) imposed a R534 million penalty on Sasol for charging domestic customers excessive prices for purified propylene and polypropylene between January 2004 and December 2007.

Kholiswa Mnisi, Hariprasad Govinda and Nompucuko Nontombana discuss the Commission’s decision to approve the merger transaction between Oceana and Foodcorp with conditions. This discussion is followed by a discussion on the Commission’s recommendation to prohibit the Ferro and Arkema Resins merger. The Commission found that the proposed merger is likely to result in a substantial prevention and lessening of competition.

We have introduced a policy brief series, which is meant to catalyse competition policy debates. In order to have the highest possible impact, a policy brief will contain the most relevant findings and key messages which will inform stakeholders. A policy brief will present an expert view on a particular issue. In this issue, we have included two policy briefs, one on airline competition and the other on generic pharmaceuticals.

Air transport has radically evolved over the last two decades. Since the airline sector has been de-regulated, air travel has to a large extent become a commodity and air services have become market-driven. Driven by lower prices and growing income, air traffic for passengers and cargo has grown exponentially. The sector has seen entry and exit of firms. The airline competition policy brief explores the main competition issues in the airline sector.

The generic pharmaceuticals and competition policy brief notes that entry by generic pharmaceuticals can enhance competition in the drug market by offering more choice and by lowering drug prices to the benefit of health customers. At the same time, innovation in the pharmaceutical sector should be sustained, notably by allowing innovators to obtain intellectual property rights on their originator drug. Competition concerns arise, however, when originator companies use their intellectual property rights to delay or to prevent generic entry.

Werner Rysbergen and Nompucuko Nontombana discuss the developments in the South African plastic pipes market. The last article in this issue by Thulani Mandiriza provides an overview of the Sugar Project which was part of the Research Programme on Competition Dynamics and Regional Trade Flows conducted under the African Competition Forum (ACF).
On 05 June 2014 the the Tribunal fined Sasol Chemical Industries Limited (Sasol) R534 million for excessively pricing purified propylene and polypropylene to domestic customers. Purified propylene, produced from feedstock propylene, is a monomer that is a by-product of fuel and is used as a key input in the production of polypropylene. Polypropylene is a polymer which is a key input for converters who manufacture household products like lunch boxes, plastic chairs and plastic cups; and industrial plastic products like motor car parts and water tanks. Sasol supplies polypropylene to domestic customers at import parity prices and also sells large quantities to export customers.

The Commission received a request from the Department of Trade and Industry (DTI) in August 2007 to investigate the pricing practices in the South African chemicals sector, particularly the polymers sector. The Commission then initiated a complaint against Sasol and at the conclusion of its investigation referred the case of excessive pricing (section 8(a)) against Sasol for propylene, and polypropylene in the period 2004-2007. The Commission also referred a case for collusion (section 4(1)(b)) in relation to polypropylene against Sasol and Safripol. Both Sasol and Safripol settled with the Commission. The agreement between the Commission and Safripol was confirmed on 25 August 2010. Safripol agreed to pay an administrative penalty of R16 474 573 representing 1.5% of its turnover derived from sales of polypropylene. The agreement between the Commission and Sasol was confirmed by the Tribunal on 24 February 2011. Sasol agreed to pay an administrative penalty of R111 690 000, which represents 3% of Sasol Polymer’s turnover derived from sales of polypropylene products.

The legal framework for dealing with excessive pricing Section 8(a) of the Competition Act states that it is prohibited for a dominant firm in a relevant market to charge an excessive price to the detriment of consumers. The Competition Appeal Court (CAC) in its decision on Mittal Steel South Africa Limited and Others v Harmony Gold Mining Company Limited and Another, laid a framework to be followed in assessing excessive pricing cases in the context of section 8(a). The CAC stated that the analysis of an excessive pricing case under section 8(a) involves the following: 1) determining the actual price of the good or service in question; 2) the economic value of that goods or service; 3) whether the difference between the actual price and the economic value is unreasonable; and 4) whether the charging of the excessive price is to the detriment of consumers. In applying the guidance in the Mittal case, the Commission and Sasol used various tests namely: price cost tests, a comparison of domestic prices with prices in other geographic markets, and a comparison of Sasol’s export prices with domestic prices for each product.

Key Tribunal findings

Regarding propylene, the Tribunal relied on the price cost tests done by the Commission and Sasol. The Tribunal came to the conclusion that Sasol’s markup of purified propylene prices over actual costs for the period 2004-2007 were on average 31.5-33% for both Tier 1 and Tier 2 sales. The Tribunal did not did not attach weight to the imputed export price for purified propylene and the prices charged by other firms in other geographic markets as advocated by the Commission.

Regarding polypropylene, the Tribunal used the price cost test, export price comparison and took into account the polypropylene prices of other firms in other domestic markets. Firstly, on the price cost test, the Tribunal found that on a conservative basis, Sasol’s mark up of its polypropylene prices over actual costs in the period 2004-2007 was 17.6%-25.4%. On a more realistic basis the Tribunal concluded that the markup were in the range of 26.9-36.5%. Secondly, the Tribunal found Sasol’s markup margins to be on average 23% higher than average deep sea exports. Thirdly, the Tribunal found that Sasol’s markup was 41% and 47% higher for homopolymer and raffia grade polypropylene respectively for the period 2004-2007 compared to the discounted prices in Western Europe computed on the basis of feedstock costs comparable to Sasol.

The Tribunal rejected the attempt by Sasol to determine economic value directly, i.e., by postulating a hypothetical market with notional competitors and their prices and costs in that market. In concluding that Sasol’s pricing does not bear any reasonable relation to costs, the Tribunal looked at the objectives of the Competition Act in the context of the South African economy, the importance of the intermediate inputs in industrial development, market characteristics and circumstances, and the history of Sasol and how it acquired its dominant position in the market. In considering the history of state support that Sasol has enjoyed. Sasol was supported, owned, and controlled by the state from its establishment to its privatization. Through legislation and regulation, the State ensured that Sasol was sustainable, profitable, and would not fail. The Tribunal also took into account Sasol’s low cost feedstock advantage. Feedstock propylene is produced in abundance in South Africa by Sasol Synfuels. The Tribunal took into account Sasol’s feedstock advantage and that it was a result of a history of state support and the abundance of natural resources. The Tribunal highlighted that this feedstock advantage was not a result of risk taking and innovation on the part of Sasol.

Remedies and its impact on the market

The Commission asked for 10% of Sasol’s turnover. The Tribunal imposed a reduced administrative penalty of R534 million, together with the imposition of a “forward-looking” behavioural remedy in relation to propylene and polypropylene. The Tribunal argued that that approach would provide relief and certainty to Sasol and its customers. The remedies have to be viewed in the light of the harm caused by Sasol’s excessive prices in that Safripol was hindered from growing in the market and manufacturers were negatively affected by the excessive prices and they, in turn, passed the effects of the high prices to the end consumer.

The following are important points to note about the remedies imposed by the Tribunal:

Propylene
- An administrative penalty of R205,2 million which should be paid to the Commission in 90 days
- Sasol must discriminate between the purified propylene charged internally within Sasol and the price charged to customers like Safripol.
- Sasol and the Commission must within 90 days submit a proposed pricing remedy to the Tribunal

Polypropylene
- An administrative penalty of R328,8 million which should be paid to the Commission in 90 days
- Sasol must sell polypropylene on an ex-works basis without discriminating in price between any of its customers no matter where they are located.
The decision of the Commission to approve the proposed merger transaction between Oceana and Foodcorp with conditions was widely reported in the media. The media reports alluded to the need for stronger regulatory oversight in the fishing industry. The Commission’s findings in relation to competition issues in this industry also suggest that through collaborative effort between the Department of Agriculture, Forestry and Fisheries (DAFF) and the Commission, there may be room to strengthen regulatory efforts in order to achieve both greater levels of competition and the transformation of the industry by easing concentration levels along the value chain.

The Commission approved the acquisition of the fishing business of Foodcorp by Oceana subject to the divestiture of the Glenryck trademark and the small pelagic fish quota allocated to Foodcorp by DAFF. Foodcorp's fishing business constitutes the business of harvesting, processing and marketing deep sea trawl hake, south coast rock lobster (SCRL) and small pelagic fish (i.e. pilchard, anchovy and red eye) and the Glenryck trademark. Oceana is active in the vertically integrated markets for harvesting, processing and marketing deep sea trawl hake, SCRL and small pelagic fish and it owns the Lucky Star trademark.

The Commission found that the proposed transaction was not likely to result in anticompetitive effects with respect to the vertically integrated markets for harvesting, processing and marketing of deep sea trawl hake and SCRL. However,
Continued from page 5

with respect to the market for harvesting, processing and marketing of small pelagic fish, the Commission’s investigation found that the merger will substantially prevent or lessen competition in the vertically integrated market for the harvesting, processing and marketing of canned pilchard to the detriment of competition.

The Commission’s findings

From its investigation, the Commission found that it is important to own a strong brand and have access to sufficient quota of small pelagic fish allocation in order to effectively compete in the market for the harvesting, processing and marketing of canned pilchards. The Commission found that the sale of the fishing business of Foodcorp to Oceana would result in the removal of Oceana’s closest competitor in this market. Post-merger, Oceana would account for more than 80% of the market whilst its closest competitor would account for less than 10% of the market. The Commission also found that the vertically integrated market for the harvesting, processing and marketing of canned pilchards is characterised by high barriers to entry and expansion in the form of regulatory barriers, high capital outlays, brand loyalty and input scarcity, amongst other barriers.

The merging parties also contend that the Competition Authorities’ decision would result in job losses as Oceana would likely walk away from the deal if the small pelagic fish quota is not part of it. According to the merging parties, this would result in Foodcorp closing its processing plants and discontinuing its harvesting activities, translating into the retrenchment of at least a 1 000 employees. In this regard, the Commission argued during the Tribunal hearing that Foodcorp could sell/ transfer its small pelagic fish quota to another purchaser other than Oceana. Foodcorp certainly did not need the ‘Oceana deal’ to save potential job losses. Indeed there were two potential buyers of Foodcorp’s fishing business who testified at the Tribunal that they were willing and able to purchase Foodcorp’s fishing business. One of the two potential buyers testified during the hearing that although Oceana has a higher BEE rating compared to Foodcorp, hence DAFF approved the transfer of Foodcorp’s fishing rights, his firm has a higher Black Economic Empowerment (BEE) rating (i.e. 100% black-owned) than Oceana. This witness argued that by approving the transfer of Foodcorp’s fishing rights to Oceana an opportunity to transform the fishing industry along the value chain in line with government policy was missed.

Conclusion

There have been some commendable feats achieved in the fishing industry especially pertaining to breaking concentration levels in the allocation of fishing rights. However, the Commission found that the harvesting, processing and the marketing levels of the value chain are still concentrated, with only few firms who have the capacity and ability to invest in vessels and processing plants. Furthermore, a number of black-controlled companies (i.e. small quota holders) are registered as fishing rights holders however few of these companies are actually operating in the harvesting, processing and marketing of fish. This is largely because the fish quotas allocated to them would not justify investing in vessels, plants, and so forth. Small quota holders would therefore ‘sell’ their quota to the big firms who already have vessels and processing plants.

The South African competition policy regime recognises the need for transformation and envisages more than just black shareholding given the history of high levels of concentration, control and exclusion. The Competition Act seeks to balance competition and socio-economic objectives. This is in line with the industry’s regulations as DAFF considers the degree of transformation of the transferee and the extent to which the ownership of the quota and vessels would change upon the approval of the transfer of the fishing rights.

The advancement of transformation and competition in the fishing industry therefore requires innovative thinking on the part of regulators. The objective of policy formulation should be aimed at easing barriers to entry along the fishing value chain. This will allow smaller quota holders to compete effectively, along the value chain, both in South Africa and in international markets.
THE COMMISSION RECOMMENDS THAT THE RESIN INDUSTRY MERGER BE PROHIBITED

Kholiswa Mnisi, Hariprasad Govinda and Nompucuko Nontombana

On 12 December 2013, Ferro Industrial Products (Pty) Ltd (Ferro) notified the Commission of its intention to acquire Arkema Resins (Pty) Ltd (Arkema SA), a subsidiary of a French company, Arkema Afrique SAS (Arkema). In terms of the proposed transaction, Ferro and Arkema have also entered into a licensing agreement and will be entering into a Technical Assistance and Distribution Agreement which will allow Ferro to gain access to Arkema’s coating resin technology and a range of global brands.

Following a 4-month long investigation, on 8 May 2014 the Commission referred a recommendation to the Tribunal to prohibit the proposed merger as it would result in a substantial prevention and lessening of competition in the resin market. The merging parties are both active in the market for the manufacture and supply of unsaturated polyester resin (UPR) also referred to as composite resin. In general terms, a resin is a solid or liquid synthetic organic polymer used as the basis for plastics, adhesives, varnishes, or other products and is valued for its chemical properties and uses such as the ability to harden with the application of heat or pressure, or a combination of both.

In assessing the proposed transaction, the Commission distinguished between UPR used in the mining segment and UPR used in ‘other segments’. The UPR supplied to the mining industry is used to make grout, capsules and sausages for underground mines by adding fillers to the resin. This is then used for roof support, which is critical for safety in the mining sector. In ‘other segments’ UPR is widely used to reinforce fibreglass for end use applications in the building and construction sector, pipes and tanks, mining, automotive and transportation, marine, arts and craft and similar sectors.

In the mining segment, the merging parties are currently the only suppliers of UPR such that the merger would result in the removal of an effective competitor, leaving Ferro to enjoy a monopoly position post-merger. The Commission found that currently the merging parties are the only two local manufacturers who have the capability and ability to supply UPR of the desired and regulated specification to the mining segment.

The Commission also found that in other segments, the proposed merger would result in the merged entity gaining a significant share of the market of approximately 64%, with the closest competitor having approximately 16%. The rest of the market is accounted for by a small local supplier and some imports.

The Commission found that there are high barriers to entry in the UPR market due to the high capital outlay required for entry, economies of scale and the existence of excess capacity. In the mining segment, there are additional barriers to entry in the form of reputation, technology, technical expertise and technical specifications required. The excess capacity may also be used as a strategic deterrent for entry and expansion. This merger would further exacerbate these barriers to entry in the UPR market.

The end-user segments which are likely to be adversely affected by the implementation of the proposed transaction include the mining segment (i.e. manufacturers of grout and resin capsules), building and construction (i.e. manufacturers of swimming pools, baths and sanitary ware) and the automotive sector (i.e. manufacturers body into the automotive industry).

The Commission considered possible remedies such as divesture of Arkema’s composite business, but this was not deemed to be viable as the firm’s coatings business is also located in the same plant, making it impractical to separate them. The merging parties also proposed a pricing formula applicable for two years, which in the Commission’s view could address the anticompetitive effects arising from the structural changes in the market brought about by the proposed transaction, both in the short and long run. Public hearings on the merger are to take place in July 2014.
Merger Activity Update

In quarter 4 the Commission finalised 82 merger notifications (76 approved without conditions and six approved with conditions).

During the same period the acquisition of the fishing business of Foodcorp Proprietary Limited (Foodcorp) by Oceana Group Limited, which was on review before the Tribunal, was approved subject to the divestiture of the Glenryck Trademark and the small pelagic fish quota allocated to Foodcorp by the Department of Agriculture, Forestry and Fisheries. The merging parties have since filed a notice to appeal the Tribunal’s decision.

The Commission imposed conditions on 3 cases from March 2014 to May 2014. Two of the three cases dealt with public interest remedies. In both these cases, the Commission capped the number of job losses that would arise from the merger.

Another case was the National Asphalt and Shisalanga merger, in which the Commission imposed a remedy aimed at preventing cross directorships and information exchange that may arise from the cross directorships.

Industries with high merger activity for the 2013/2014 financial year were property (28%) and manufacturing (22%). There was some activity in the mining (7%), healthcare (3%) and information technology industries (4%).

A division is also monitoring over 100 mergers that have been conditionally approved in the past. This is another area of focus for the Commission to ensure firms implement the undertakings committed upon approval of transactions.

There is a worrying trend of investigations of mergers that have been implemented without the prior approval of the Commission, which is a concern given the mature state of competition law regulation in South Africa. In the main, these cases are identified during the investigation of related merger transactions as well as complaints from the general public. The Commission will remain vigilant and take firm action against companies that implement mergers in violation of the Competition Act.
The Commission published the Terms of Reference (ToR) in relation to its first market inquiry of this nature, i.e. the Market Inquiry into the Private Healthcare Sector, on 29 November 2013 as required by the Competition Act. The ToR define the scope of the inquiry and since its publication the Commission has appointed an Inquiry Panel (the Panel) of five experts who will conduct the inquiry by, inter alia, presiding over public hearings, reviewing submissions, examining evidence and overseeing the drafting of the inquiry reports and recommendations. The Panel was introduced to the public and relevant stakeholders on 30 January 2014.

On 16 April 2014, the Panel held a stakeholder engagement session at the Balalaika Hotel in Sandton. The purpose for this engagement was to talk to stakeholders about what it is that they can expect from the Panel in the market inquiry and also what is expected of them during the inquiry. This engagement was attended by a number of stakeholders including medical schemes, practitioners, hospital groups, industry bodies and associations, regulators and civil society organisations.

At this engagement the inquiry’s Chairperson explained to the stakeholders present the reasons for the delays faced with proceeding with the inquiry; including the current litigation between Netcare and the service provider appointed by the Commission to assist in providing technical support in the inquiry, KPMG. The litigation relates to Netcare seeking an interdict barring KPMG from doing work for the Commission on the basis that KPMG is conflicted on account of having done work for Netcare.

After explaining the underlying principles that led to this inquiry the Chairperson then addressed a number of key issues that were relevant and laid down the rules of engagement for inquiry including but not limited to:

- The use of information obtained during the inquiry in subsequent actions: the Chairperson explained that the discretion of whether to use information obtained during the inquiry in any actions against a party remained with the Commission and no guarantees could be given to stakeholders at this stage;

- Confidentiality: it was explained to the stakeholders that even though the inquiry will take the form of an inquisitorial, open and transparent process; allowance for appropriate claims of confidentiality in terms of the Competition Act will be made.
Guidelines for Participation: the Chairperson indicated that the Commission after consultation with the Panel would be issuing guidelines to stakeholders which are aimed at providing clarity on the methods of participating in the inquiry. These guidelines will be accompanied by an Administrative Timetable and will be made available to all stakeholders for comment on 31 May 2014.

Statement of Issues: it was also indicated that the Panel will publish a Statement of Issues that will provide interested parties with insight on the preliminary framework for the issues, topics and possible theories of harm that will be considered by the Panel during the inquiry. These were published for public comment on 30 May 2014.

The Inquiry Chairperson emphasised to stakeholders how important it would be for them to cooperate with the Inquiry process and to provide the Panel with accurate information which will allow them to make the appropriate recommendations.

Having noted that the right of access to healthcare is a fundamental human right, former Chief Justice Ngcobo concluded by stating: “It is therefore in the interest not just of competition that the private healthcare sector functions effectively and efficiently, but in the public interest that the private healthcare markets function in a manner that promotes rather than undermines the purposes of the Act”.

Any person wishing to comment on the Guidelines for Participation and the Statement of Issues can access them the Commission health inquiry website (www.healthinquiry.co.za) or can contact the Inquiry at health@compcom.co.za.

### Even though the Administrative Timetable for the inquiry will be made available to all relevant parties and updated as necessary, the following important dates have been identified for the inquiry

<table>
<thead>
<tr>
<th>Date</th>
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<tr>
<td>31 May 2014</td>
<td>Statement of Issues and the Guidelines for Participation issued for public comment</td>
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<tr>
<td>30 June 2014</td>
<td>Receive comments on the Statement of Issues and Guidelines for Participation</td>
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<tr>
<td>1 July 2014 – 31 July 2014</td>
<td>Consider comments on Statement of Issues and Guidelines for Participation</td>
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<tr>
<td>1 August 2014</td>
<td>Publish Final Statement of Issues and Guidelines for Participation</td>
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<tr>
<td>1 August 2014</td>
<td>Call for submissions on subject matter of the Inquiry</td>
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<tr>
<td>1 August 2014 – 30 October 2014</td>
<td>Receive submissions on subject matter of the Inquiry</td>
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<tr>
<td>1 November 2014 – 31 January 2015</td>
<td>Analysis of information</td>
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<tr>
<td>1 March 2015 – 30 April 2015</td>
<td>Public hearings</td>
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<tr>
<td>1 May 2015 – 31 July 2015</td>
<td>Analysis and targeted public hearings and information requests</td>
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<tr>
<td>October 2015</td>
<td>Publishing provisional findings and recommendations</td>
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### COMMISSION LAUNCHES

#### LPG market inquiry

The Commission published the ToR for the market inquiry into the liquefied petroleum gas (LPG) sector on Friday, 20 June 2014. The Commission initiated a market inquiry into the LPG sector as it has reason to believe that there may be features of the sector that prevent, distort or restrict competition.

The South African LPG sector has been identified as being of strategic importance to the economy as an alternative source of energy by the various government policies. The National Development Plan for instance alludes to increasing the proportion of LPG in the country’s energy mix in order for South Africa to meet its strategic objectives of a sustainable supply of energy. Further, the LPG sector is characterised by high switching costs and an extensive price regulation framework at some levels of the value chain. It is therefore important that the LPG sector is functioning effectively in order for South Africa’s energy policy objectives to be met.

The inquiry will assess competition dynamics at various levels of the value chain. The market inquiry will provide a factual basis for making recommendations to relevant stakeholders to ensure that competition is enhanced. The market inquiry is likely to be completed by October 2015.
The Construction Fast Track Settlement Project (Fast Track Settlement), which was launched in February 2011, was completed in July 2013 when the Tribunal confirmed 15 consent agreements as orders of the Tribunal. This paved the way for the participating construction firms to pay an administrative penalty totaling R1, 47 billion.

However, the Commission’s investigation of collusive practices in the construction sector was not concluded. The Commission continued to investigate construction cases/projects that were not settled under the Construction Fast Track Settlement. This is the second phase of the Commission’s investigation in the construction sector following the Fast Track Settlement and it is referred to as ‘the Phase II Construction Investigation’.

This investigation is about firms that participated and settled certain projects under the Fast Track Settlement but refused to settle some projects in which they were implicated; firms that participated in the Fast Track Settlement but refused to settle projects they disclosed; and firms that did not participate at all in the Fast Track Settlement but were implicated in certain projects under the Fast Track Settlement.

The firms that participated and settled under the Fast Track Settlement but refused to settle certain projects they are implicated in are: Basil Read with 4 projects, WBHO with 4 projects, Raubex with 2 projects and Murray & Roberts with 1 project. The firms which participated in the Fast Track Settlement but refused to settle certain projects they disclosed are WBHO with 1 project and Power Construction with 1 project.

Twenty four firms are implicated in construction cases/projects but did not participate, at all, in the Fast Track Settlement. These firms are implicated in 31 projects/cases, excluding duplicates. Duplicate projects are projects that more than one firm is implicated in. When including duplicates, the number of cases/projects involved in this category of firms is 54.

In terms of the Phase II Construction Investigation, the Commission created a penalty regime that encourages firms that are willing to settle their implicated projects on terms better than when they would if they are prosecuted. This is however not the Fast Track Settlement and it is also not the same with the Fast Track Settlement. At the heart of this penalty regime is consistence. The Commission wants to ensure that firms with same number of project with same nature of collusive conduct get the same penalty. The table below outlined the said penalty regime.

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of non-prescribed projects</th>
<th>Range of penalty percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1 to 4</td>
<td>2% to 5%</td>
</tr>
<tr>
<td>B</td>
<td>5 to 12</td>
<td>6% to 9%</td>
</tr>
<tr>
<td>C</td>
<td>13 to 22</td>
<td>10% to 13%</td>
</tr>
<tr>
<td>D</td>
<td>23 and over</td>
<td>14% and over</td>
</tr>
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</table>

In terms of this methodology, a firms which is implicated in 1 to 4 projects/cases will be levied a penalty of between 2% to 5% depending on the mitigating and aggravating factors.

Some of the firms that did not participate in the Fast Track Settlement but were implicated have already concluded settlement negotiations with the Commission and the Commission has already applied to the Tribunal to confirm these consent agreements as orders of the Tribunal. Other firms are currently negotiating settlements with the Commission whilst others have decided that they will defend themselves. The firms that have decided to defend themselves are collectively implicated in 20 projects/cases. These firms included firms that participated in the Fast Track Settlement but refused to settle certain projects they are implicated in, including Group Five. Since the Commission has now made significant progress in negotiating and concluding settlement agreement with the firms that are willing to settle, it has now prioritized referral of the firms that want to defend themselves and intends to complete this part of the process by October 2014. When referring these cases to the Tribunal for prosecution, the Commission will treat each project as a case on its own and will request the Tribunal to impose the maximum penalty of 10% of the firms’ annual turnover for each project/case upon the successful prosecution.

The firms that thus far decided to defend themselves can, however, still negotiate with the Commission to settle their implicated projects/cases. But penalties for these firms will not be in accordance with the methodology outlined above, as they have missed that opportunity. But these firms can still avoid having to pay a penalty equivalent to 10% of their annual turnover for each project should they be found guilty by reopening the settlement negotiations.
Bid Rigging Training: Seychelles

The Seychelles Fair Trading Commission (FTC) hosted a one-week training session on Bid Rigging/Procurement from 31 March to 4 April 2014. The Commission provided training assistance to employees of the Seychelles FTC and to its public procurement officials by sending two Commission staff members, namely, Mr Anthony Ndzabandzaba (Principal Investigator, Cartels) and Ms Nelly Sakata (Principal Legal Counsel) to conduct training for its investigators, competition and legal officers. The training concentrated on the review of the FTC’s draft leniency policy and leniency procedures, cartel investigation techniques and cartel enforcement methods.

During the same week, the FTC organized a two-day workshop from 3 to 4 April on ‘Fighting Bid Rigging in Public Procurement’ which was facilitated by both Nelly Sakata and Anthony Ndzabandzaba. The training was aimed at equipping public procurement officials on how to detect and prevent bid rigging. Participants from both government and business attended, including the Procurement Oversight Unit, The National Tender Board and other authorities and agencies to help eliminate anti-competitive practices in the Seychelles.

Both Ms Sakata and Mr Ndzabandzaba received positive feedback on the training they conducted. In a letter addressed to the Commission, dated 24 April 2014, the CEO of the FTC, Mr Georges Tirant stated as follows:

‘The Fair trading Commission of Seychelles wishes to thank the Commission of South Africa for its generous assistance in conducting a Bid Rigging workshop to stakeholders, as well as the in-house training conducted for FTC staff on cartel detection and raids. The FTC has greatly benefited from the experience and skills shared by Mr Ndzabandzaba and Mrs Sakata during their visit and hopes to conduct further training during the next year. The FTC greatly hopes to continue this relationship through the exchange of expertise and skills between the two Commissions and wishes to propose that the two Commissions enter into a memorandum of understanding with the aim of consolidating this cooperation’

ICN Conference: Marrakech, Morocco

Commissioner Tembinkosi Bonakele; Junior Khumalo, Divisional Manager: Enforcements and Exemptions; and Hardin Ratshisiusu, Divisional Manager: Mergers and Acquisitions represented the Commission at the 2014 International Competition Network (ICN) conference in Marrakech, Morocco from 22 to 25 April 2014. This was the 13th meeting of its kind themed: “More than a meeting, it’s our future”.

The Commissioner was a panellist for the Special Projects plenary session on state-owned enterprises under Competition Law. Hardin Ratshisiusu participated as a panellist in the break out session on “Fostering convergence in merger notification and procedures: Challenges for new competition agencies and the role of MWG outreach”. During the World Bank’s pre-ICN event the research output of the ACF was presented, showcasing studies covering 3 sectors (cement, poultry and sugar) across 6 countries in the southern and eastern African region, Mr Junior Khumalo presented the study on cement.

African Competition Forum, Investigative Skills Workshop: Mauritius

Three Commission staff members, Grashum Mutizwa, Reabetswe Molotsi and Mogau Apane participated in the ACF’s capacity building workshop held in Mauritius from 28 to 29 May 2014. The aim of the workshop was to teach investigators how to go about investigating suspected violations of competition law. It achieved this by looking at the goals of competition law, with an emphasis on how to operationalize those goals through law enforcement.

The seminar proceeded to look at the main categories of business practices that would likely have an adverse effect on competition – agreements that restrain trade, abuse of dominant positions, and mergers and acquisitions that substantially lessen competition – by identifying the “elements of proof” and key facts that are necessary to prove a violation of the law.

Furthermore, practical guidance was given on the systematic planning and conducting of investigations in order to determine whether the law has been violated. Specific investigative techniques were also studied particularly as it pertained to gathering facts, requesting and reviewing documents and data, and interviewing witnesses. Factual case studies supplied by the US Federal Trade Commission were also used throughout the workshop to illustrate the most important lessons.

Recent and Upcoming International Events:

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
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<tbody>
<tr>
<td>16-19 June 2014</td>
<td>OEC Competition Committee Meetings, Paris</td>
</tr>
<tr>
<td>20 June 2014</td>
<td>ACM Conference Innovation in Oversight, The Hague, Netherlands</td>
</tr>
<tr>
<td>14-18 July 2014</td>
<td>Regional Workshop on Practical Skills for Planning and Conducting Investigations, Pretoria</td>
</tr>
</tbody>
</table>
1. INTRODUCTION AND BACKGROUND

Established in 1935, South African Airways (SAA) is South Africa’s leading airline operator. Up until 1991, SAA, as the flag carrier, was protected from competition. Over this period SAA was the only service provider on all main domestic routes. Airlines that hoped to compete with SAA were required to prove, amongst others things, that a need for their services existed and that the incumbent airline was not delivering an adequate service. The requirements were a significant barrier to entry. As a result SAA had a monopoly on the high density routes with the private sector airlines being relegated to feeder routes.

Post deregulation, the next ten years were characterised by entry and exit of several airlines. SAA continued to provide air transport services in the domestic market, abut faced some competition. A three tiered alliance was established late in 1993 between SAA, South African Express (SA Express) (operating lower-density domestic routes; Bloemfontein, Kimberley, East London) and South African Airlink (SA Airlink) (operating feeder routes to the main hubs in South Africa as well as regional air transport services) which enabled the airlines to provide an expanded service offering.

Comair is a privately owned South African company listed on the Johannesburg Stock Exchange (“JSE”). Comair was established in 1946, but entered the mainstream routes in 1992. Comair increased its market presence when it partnered with BA Plc in 1996, to operate under the BA brand and also when it launched Kulula in 2001.

In the first ten years following deregulation, airlines that entered the market included Flitestar, Nationwide, Phoenix Airways and Sun Air; however, none of these airlines were able to gain significant market share in the domestic market with all subsequently exiting.

Since 2001, the domestic air transport market has been characterised by the entry and exit of the low-cost carriers. Kulula was the first low-cost carrier to enter the South African market and 1Time entered the market in 2004 and exited in 2012. Mango Airlines (“Mango”) entered the market in 2007. SAA owns Mango. Velvet Sky entered the market in 2011 and exited in 2012.

Regulation has recently emeyed as a significant barrier to entry. In particular, the Airline Services Licencing Act of 1990, this Act stipulates a maximum threshold of 25% foreign ownership in any license holding company, with the Transport Minister being eligible to waive this threshold should he/she find such cause. Importantly though, there has never been a successful application for this exemption. In addition, the Airports Company of South Africa (ACSA) is a state owned monopoly that owns and operates nine airports across the country. ACSA’s charges include landing charges, passenger service charges and aircraft parking charges. Its charges are regulated by the Regulating Committee, established through the Airports Company Act of 1993. The Regulating Committee does not regulate market access or grant licenses.

In this submission, we briefly discuss the main competition issues in the South African airline industry.

1 The three private airlines on these feeder routes prior to 1990 included: Comair (operational since 1944), Link Airways (later known as SA Airlink) (operational from 1978) and Bop Air (later known as Sun Air) (operational from 1979).
4 From 1995 to 2008: Phoenix airways focused on the Johannesburg, Durban and Cape Town routes.
5 From 1994 to 1995: Sun Air operated on the main domestic routes in South Africa.
6 Entered in 1994 and purchased by SAA in 1999.
2. COMPETITION ISSUES IN THE AIRLINE SECTOR

2.1. Abuse Of Dominance

2.1.1. SAA I

In July 2005, the Tribunal found that SAA contravened section 8(d)(i) of the Competition Act because it had engaged in two prohibited practices in the period from 1999 to 2001 (“SAA I”). These practices were referred to as the ‘override incentive scheme’ and the ‘explorer scheme’.

The override incentive scheme involved incentive contracts between SAA and a large proportion of South African travel agents. The contracts were designed such that the agents received a flat basic commission for all SAA sales up to a target in Rand, specified in the contract. When the target was reached, the agents were eligible for two further types of commission in addition to the basic payment:

- The ‘override commission’ was paid if the agent exceeded the target. This commission was paid not only on the amount above the target, but on the whole amount below and above the target, referred to as the ‘back to rand 1’ principle.

- The second type of commission was paid only on the amount in excess of the target (the incremental sales), referred to as the ‘back to rand base’ principle.

The second practice of the incentive agreements, the explorer scheme, was aimed at rewarding individual travel agency staff with free travel on SAA flights in return for reaching sales targets for SAA tickets. It operated in a similar way to a frequent-flyer scheme. Therefore, rather than targeting travel agencies as a whole, the scheme provided the individual travel agents with a strong personal incentive to sell SAA tickets. The explorer scheme came to an end in June 2002.

The Tribunal found SAA being dominant had abused its dominant position by implementing the travel agent commission payment scheme during the period between October 1999 and May 2001. This was primarily due to the fact that this scheme had a retroactive ‘back to rand 1’ structure. For this conduct, the Tribunal imposed an administrative fine of R45 million.

2.1.2. SAA II

SAA I related to agreements that SAA had in place from 1999 to 2001. However, various similar agreements remained in place beyond 2001.

Comair lodged a complaint with the Commission about these post-2001 agreements in October 2003. The complaint was referred by the Commission to the Tribunal for adjudication in October 2004.

Shortly after the SAA I, SAA’s agreements were changed. The elimination of the retroactive design of the incentive contracts, applicable from April 2005, then formed part of a settlement agreement with Commission. The Tribunal confirmed the settlement agreement in December 2006. SAA agreed to pay an administrative fine of R15 million. The settlement agreement did not contain an admission of liability on the part of SAA for the period between May 2001 and March 2005. As a result, Comair and Nationwide chose to continue to fight the case at the Tribunal. A finding of contravention is a prerequisite for the institution of an action in the High Court for damages.

In February 2010, the Tribunal found that SAA had abused its dominant position during the period between May 2001 and March 2005. Essentially, SAA II related to similar conduct the covered in SAA I, the only difference being that the SAA II decision extended the analysis of effects that is contained in SAA I. Federico (2013) explains that the SAA loyalty discount cases represents a clear example of why rivals in the market were not able to profitably match the incentive schemes of SAA which led to their foreclosure in the domestic market.

Lastly, it should also be noted that the Commission is currently investigating a complaint brought against SAA by Comair in November 2012. Comair is alleging that SAA has contravened the Competition Act by providing incentives to travel agents to sell passengers tickets on SAA flights rather than those of competitor airlines, such as BA/Comair. The Commission is currently investigating the allegations.

2.1.3. Market definition

In SAA I, the relevant market was defined as the overall domestic airline market in South Africa, without distinguishing it by type of passenger and/or fare, or by route. This was regarded appropriate at the time given that by May 2001 no low-cost carrier had entered the South African domestic market (see Federico 2013). Moreover, a route-by-route definition of the market was not relevant at the time given that SAA’s conduct as alleged in that investigation affected all domestic routes at the same time by virtue of the fact that the incentive schemes were based on total domestic sales made by travel agents.

The issue of market definition was however greatly contested and debated during the second abuse of dominance heard by the Tribunal in 2008 and 2009 (SAA II). This was not so much for its implications on the evaluation of SAA’s dominance, but rather for its impact on the analysis of effects. Indeed, as correctly stated by Federico (2013), the SAA II case provides a good example of a case where market definition was not considered as an end in itself, but was primarily used as an analytical tool to properly isolate and identify the possible anti-competitive effects of the conduct of a firm with significant market power.

The main market definition issues at stake in SAA II revolved around the significant changes that had taken place in the South African domestic airline market since 2001. Kulula was launched as a low-cost carrier by Comair in August 2001 and this was also subsequently followed by the entry of another low-cost carrier entrant in the form of 1Time in 2004. The growth of low-cost carriers between 2001 and 2005 which is the relevant time period for the complaint in the SAA II case raised the issue of whether the market definition adopted by the Tribunal in SAA I should be modified. As explained in the context of SAA II, this market definition question had significant implications for the effects that could be potentially attributed to SAA’s conduct.

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If the market had been defined in SAA II as a unique and largely undifferentiated market, this would have implied that bypass opportunities would have been available both to SAA’s competitors and to its consumers. This would be as a result of the ability of SAA’s rivals to mitigate and circumvent much of the foreclosing effect of SAA’s conduct by selling tickets through the internet. Similarly, passengers would have been able to escape most of the associated consumer harm by buying their tickets online. However, the evidence before the Tribunal pointed to the presence of a significantly differentiated market, and arguably to the existence of separate markets for time-sensitive and non-time-sensitive passengers.

Ultimately, the Tribunal did not depart from the definition of the market definition adopted in SAA I and found in favour of a unique market for domestic air travel in South Africa. However, it crucially recognised the extensive degree of product differentiation present in this market and identified a “Travel Agent Segment”, which included all tickets sold through travel agents and which comprised the higher fare tickets. As the Tribunal stated in its decision on the matter, the effect of SAA’s behaviour on competitors and consumers, if present, would need to be located primarily in the Travel Agent Segment which roughly comprised 70% of all sales during the relevant time period.

It is therefore apparent from the Tribunal’s decision in SAA II that the market definition proposed is required to not only undergo the hypothetical monopolist test, but also a test under which the relevant theory of harm is identified and accounted for.

2.2. Cooperation, horizontal and cartel agreements, bilateral agreements, alliances

2.2.1. Alliances

Airline alliances have become increasingly common in the airline industry. The Star Alliance is an alliance between a number of international airlines, and one of three major global airline alliances, others being Oneworld and Skyteam. In 2006, SAA applied for an exemption to join the Star Alliance. An exemption is written permission by the Commission to engage in a prohibited practice, should the application meet the criteria set out in the Competition Act.

SAA sought the exemption for a period of ten years. SAA’s exemption application was based on the fact that it was required for the maintenance or promotion of exports. After conducting its investigation, the Commission granted SAA an exemption for a period of five years on the basis that the exemption would indeed maintain or promote exports. In 2009, SAA applied for another exemption in respect of a new Star Alliance product called the Meeting Plus. The exemption was sought for a period of 10 years. Since the Commission had already granted SAA an exemption to join the Star Alliance and to participate in the provision of two similar products (the Convention Plus and Corporate Plus), the Commission granted SAA, a one year exemption so that the period for this exemption could coincide with the expiration of the initial exemption.

2.2.2. Bilateral agreements

In September 2012, SAA applied for an exemption to continue code sharing on Qantas operated flights between South Africa and Australia, for a further period of three years, from January 2013 to December 2015. The Commission had exempted the Codeshare Agreement on five previous occasions (2000, 2002, 2005, 2007 and 2010).

Essentially, SAA requested that it be permitted to engage in the following activities; (1) co-ordinate its commercial passenger airline activities with Qantas in respect of the direct routes between South Africa and Australia; (2) allocate the market in terms of which SAA will operate on the route between Johannesburg and Perth, while Qantas will operate between Johannesburg and Sydney; and (3) acquire blocks of seats, in various classes, on each other’s aircraft. SAA’s application was based on the premise that the codeshare agreement was required to maintain or promote exports as well as to stop a decline in the industry. After, its investigation the Commission granted the exemption for a period of 18 months (from January 2013 to December 2014).

In November 2013, SAA applied for an exemption in respect of a codeshare agreement with Etihad on the route between Abu Dhabi and Johannesburg. The application is based on the fact that it is required for the maintenance and promotion of exports. SAA and Etihad seek this exemption for a period of five years. The Commission is currently evaluating this codeshare agreement.

2.2.3. Horizontal and cartel agreements

The Commission has investigated several horizontal agreements and cartel arrangements in the airline industry. Below we provide a summary of the cases and settlements agreements that have been confirmed by the Tribunal.

i) Fixing of fuel surcharges and cargo rates

In July 2010, the Commission referred a complaint relating to the fixing of fuel surcharges and cargo rates in international airline freight services to the Tribunal for adjudication. This was a global cartel. The respondents in this matter were SAA Cargo, British Airways, Air France-KLM, Alitalia Cargo, Cargolux, Singapore Airlines, Martinair and Lufthansa. The airlines involved are all members of the International Air Transport Association (IATA), an international trade association for major passenger and cargo airlines established over sixty years ago.

The Commission referred two distinct cases against the airlines. The first case involved the allegation that the airlines concluded agreements, the effect of which was to fix the rate of fuel surcharges on international cargo. In the second case, the Commission alleged that the respondents were involved in price fixing of cargo rates (the rate at which airlines ship cargo on behalf of their respective customers). The Commission has concluded settlement agreements with some of the respondents in the matter.

ii) Far East Asia Complaint

In January 2008, the Commission initiated a complaint against SAA, Singapore Airlines and Malaysian Airlines for their involvement with Cathay Pacific in a cartel to fix air fare increases on both economy and business class flights into, and out of, South Africa to the Far East Asia.

The Commission found that local representatives of the firms of the respondents in this matter engaged in discussions regarding air fare rates or prices in South Africa on several occasions during 2004, 2005 and ending February 2006. The discussions related to market fare levels and increases on certain market fares for flights out of South Africa to South East Asia, Hong Kong and China. Local representatives of the respondents relied on the content of these discussions among other considerations to determine fares and gain knowledge on competitor activities and price movements in the above stated routes.

Cathay Pacific received immunity for its role in the conduct as per the Commission's corporate leniency policy. Singapore Airlines and SAA have settled the case and paid administrative penalties for their participation in the conduct. In the case of SAA, this settlement agreement also settled cases against the airline in relation to collusion concerning international air cargo surcharges (above).

3. FINANCIAL DISTRESS AND COMPETITION

Finally, we consider the potential effect of financial distress in the airline industry on competition in South Africa. Several airlines in South Africa have in recent years been making losses.

Figure 1: SAA’s and Comair’s profit/losses, FY 2007-2013

Figure 1 shows the losses and profits that SAA and Comair incurred during the past seven financial years. It further shows state aid received by SAA during the same period. State aid to SAA has been in the form of concessionary financing and guarantees. For example, SAA applied for a R5.006 billion going concern guarantee from Government, which was approved by the Minister of Finance taking effect from 1 September 2012 to 30 September 2014 (the Guarantee). The Guarantee is subject to certain conditions, in that SAA should only use R1,544 billion to raise subordinated loans for working capital purposes and draw down against the remaining R3,362 billion to be contingent on the identified risks materialising. The Guarantee reduces the cost of borrowing for SAA to below market levels and reduces the perceived risk to lenders.

The Commission has not assessed complaints relating to the exercise of public powers. Competition authorities cannot review any decision taken by government departments. Where the state exercises its power through a vehicle such as a firm, competition authorities have intervened. Perhaps what is needed is a framework that allows for a balance between the goals of correcting market failures, providing public goods and fostering economic development with possible inefficiencies and anti-competitive effects. While the Commission cannot investigate and evaluate decisions by other regulatory bodies or the exercise of public powers, the Commission can influence through advocacy and engagement with government by raising awareness and advising government on the possible anti-competitive effects preferential treatment of state owned companies may have.

Reference


12 A firm can apply to the Commission to exempt an agreement or practice, or category of agreements or practices, from the application of the Competition Act, if the agreement or practice contributes to (1) maintenance or promotion of exports; (2) promotion of the ability of small businesses, or companies controlled or owned by historically disadvantaged persons, to become competitive; (3) change in productive capacity necessary to stop decline in an industry; and (4) the economic stability of any industry designated by the Minister of Trade and Industry, after consulting the Minister responsible for that industry.
1. INTRODUCTION

We begin this submission by providing an overview of the pharmaceutical industry in South Africa and how the industry fits into the broader government policy discussions. The South African pharmaceutical industry is an important component of the Industrial Policy Action Plan (IPAP) and National Industrial Policy Framework. There are at least eight local South African generic players in this sector including Adcock Ingram, Ranbaxy, BioTech, Cipla and Feza, and at least 25 foreign originators selling drugs in the South African market. The sector is characterised by a large trade imbalance and limited capacity to manufacture active pharmaceutical ingredients.

The reliance on imports is problematic, particularly in the market(s) for Anti-Retroviral (ARVs) and Active Pharmaceutical Ingredients (APIs). South Africa is the world’s largest consumer of ARVs and yet imports all of its ARVs and 95% of its APIs. Given that South Africa is a major centre of the HIV and AIDS epidemic and accounts for about 5.4 million of the total global infections of 33 million. The treatment of such large numbers of patients with ARVs is a major public health challenge.

According to the National Association of Pharmaceutical Manufacturers (NAPM), the total sale in the South African private market for pharmaceuticals in 2013 was about R20bn (US$2bn). Local pharmaceutical manufacturers in South Africa produce mostly generics with almost all originator companies coming from abroad. The NAPM represents 24 members involved in the production and distribution of generic drugs. This excludes other local generic manufacturers such as Aspen, Adcock Ingram, Biotech and Feza. The Innovative Pharmaceutical Association of South Africa (IPASA) represents 25 companies of which most are originator pharmaceutical producers. Almost all of these companies operate at international level and include, Boehringer Ingelheim, Novartis, Eli Lilly, Pfizer, Merck, AstraZeneca and Sanofi.

Prescription drugs represent 70% of the pharmaceutical market and the rest is over the counter (OTC) medicines. In South Africa, more generic prescription drugs are sold (in volume) as opposed to originator prescription drugs, but more (in monetary value) is spent on originator prescription drugs than generic prescription drugs. Originator drugs are more expensive than generics in general.

Practices that may harm competition in the pharmaceutical sector have emerged as important and controversial issues. There are usually two forms of competition: competition among different originator brand-name drugs designed to treat the same condition and competition from generic manufacturers of drugs that are equivalent to branded drugs that have already had success in the marketplace. Both forms of competition benefit society by reducing prices and motivating innovation.

The competitive entry by generic drug manufacturers into the pharmaceutical market has been important in ensuring substantial benefits to consumers and reducing costs of health care to millions of poor persons living with HIV and AIDS. Yet the benefits of generic competition, the static price reductions and their associated consumer benefits must be balanced against the important dynamic benefits of continued investment in the development of new drugs.

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To put context to the discussion, we highlight below some of the cases that the Commission has dealt with in the pharmaceutical industry. The Commission’s assessments did not view patent rights as being beyond competition scrutiny. Rather, the exploitation of these rights was assessed against competition principles and the benefits they provide to end-consumers.

2. COMPETITION CASES

2.1. THE HAZEL TAU & OTHERS V. GLAXOSMITHKLINE (GSK) & BOEHRINGER INGELHEIM (BI) (HAZEL TAU CASE)

One of the most notable cases raising intellectual property issues in South Africa was Hazel Tau case. The complaint was filed by individuals infected with HIV and AIDS, health care professionals, trade unions, and several non-governmental organisations. In particular, the complainants alleged that GSK and BI violated the Competition Act by charging excessive prices for their patented ARV medicines.

The Commission expanded the investigation to include allegations that GSK and BI had further violated the Competition Act by refusing to give competitors access to an essential facility when it was economically feasible to do so, and by engaging in exclusionary conduct. These complaints were based on allegations of the failure by the pharmaceutical firms to licence their patents on reasonable commercial terms.

At the conclusion of the investigation, the Commission announced that it was referring the matter to the Competition Tribunal for adjudication. The Commission found that GSK and BI had abused their dominant positions in their respective ARV markets. They had charged excessive prices, refused to give competitors access to essential facilities when it was economically feasible to do so and engaged in exclusionary behaviour in which the anti-competitive effect outweighed technological, efficiency or other pro-competitive gains.

Before the referral and prosecution of the case, GSK and BI, negotiated a settlement agreement in terms of which they admitted no liability. GSK and BI agreed to:

- grant licences to generic manufacturers;
- permit the licensee’s to export the relevant ARV medicines to sub-Saharan African countries;
- where the licensee did not have manufacturing capability in South Africa, permit the importation of the ARV medicines for distribution in South Africa only, provided all the regulatory approvals were obtained;
- permit licensees to combine the relevant ARVs with other ARV medicines; and
- not require royalties in excess of 5% of the net sales of the relevant ARV’s.

In 2007, the Commission received another complaint relating to HIV and AIDS medicine from the Treatment Action Campaign (TAC) alleging that Merck (and its South African subsidiary, MSD) has abused their dominant positions in the markets for the ARV medicine efavirenz (EFV) by refusing to license other firms to import and/or manufacture generic versions of this medicine on reasonable and non-discriminatory terms. MSD holds a twenty-year patent on efavirenz that expired in 2013. The TAC case resulted directly in MSD and Merck reaching agreement with multiple licensees on reasonable terms to bring a wide range of generic products containing EFV (an essential drug used as part of first-line ARV treatment in South Africa) to market. While, the Hazel Tau case was settled only after the Commission had taken a decision to refer the matter to the Tribunal for adjudication, the TAC case was resolved before the Commission completed its investigation on the matter.

2.2. THE GLAXOSMITHKLINE (GSK) / ASPEN MERGER

In February 2009, Aspen notified the Commission of its intention to acquire the Lanoxin brand from GSK South Africa. In terms of the transaction filed in South Africa (which formed part of a broader international transaction) Aspen, a generic pharmaceutical company, acquired control over the pharmaceutical business of GSK in South Africa. In return GSK became the single largest shareholder in Aspen holding 16% of the entire issued share capital of Aspen.

The Commission considered whether the merger would have substantially prevented or reduced potential competition between Aspen's pipeline products and GSK's products coming off patent, within the next five years. In each of the Anatomical, Therapeutic (ATC) categories coming off patent in the next five years, the Commission found that there was likely to be sufficient competition from other generic manufacturers both in South Africa and internationally. This would prevent the merged entity from substantially lessening competition in the future. To address the Commission’s concerns regarding Abacavir, GSK subsequently decided to extend the voluntary licences to Adcock Ingram, Cipla Medpro, Ranbaxy, Biotech
Laboratories and Feza Pharmaceuticals and provided the Commission with signed copies (by GSK) of the licensing agreements on 27 August 2009. The Commission was of the view that the undertakings and licensing offers made by GSK to the various generic firms would sufficiently address the potential competition concerns arising from this merger in relation to Abacavir and subsequently approved the merger subject to the condition that GSK licence Abacavir to the identified firms and other interested parties on terms no less favourable than those offered to Aspen.

To avoid the reversal of gains obtained by licensing of patented products in the Hazel Tau case (above), the Commission sought conditions for extension of the license of antiretroviral medicines to include the Abacavir product. Abacavir was a GSK patented product which was used primarily for the treatment of children suffering from HIV. At the time of the merger, GSK was the only supplier of this product in South Africa. The Commission sought and obtained as a condition for the approval of the merger an undertaking by GSK to not only license the production and/or importation of this product by Aspen but to also extend the license to other generic companies.

2.3. ASPEN PHARMACARE HOLDINGS LIMITED & MYLAN INC., MYLAN LABORATORIES LIMITED AND MYLAN SOUTH AFRICA INC (“ASPEN MYLAN CASE”)

In September 2012, the Commission received a complaint from Medesins Sans Frontieres, commonly known as Doctors Without Borders (“MSF”) against Aspen Pharmacare Holdings Limited (“Aspen”) and Mylan Inc. (“Mylan”). The complaint by MSF concerns a vertical supply agreement for the supply of active pharmaceutical ingredients (“API Agreement”) between Aspen and Mylan which, inter alia, allegedly precludes Mylan from bringing its fixed dose combination antiretroviral drugs to the South African market. The Commission is at an advanced stage with its investigations and a decision will be made in the coming few months.

3. THE NATIONAL DRUG POLICY

Section 27 of the Constitution of South Africa (Act 108 of 1996) recognizes that all South Africans have a right to healthcare services and imposes the duty on the state to take reasonable legislative and other measures to realise this right. In line with this, South Africa’s National Drug Policy (NDP) was published in 1996. The NDP was government’s way of “ensuring an adequate and reliable supply of safe, cost-effective drugs of acceptable quality to all citizens of South Africa and the rational use of drugs by prescribers, dispensers and consumers”.

In order to promote the availability of safe and effective drugs at the lowest possible costs, the NDP recommended that a pricing committee be established within the Department of Health (“DoH”) to monitor and regulate drug prices; and recommended the use of generic drugs.

Following the mandate of the NDP, the South African government introduced a single exit price (“SEP”) for generic and branded medicines in 2004 and put a stop to discounts and additional levies on medicines. This was done in the hope of ensuring transparency in medicine pricing and following the discovery of excessive secret rebates passing between manufacturers and private hospitals. The medicine pricing regulations provided only for the addition of a dispensing fee to the SEP. In terms of the SEP pricing regulations, pharmaceutical manufacturers must annually submit applications for price increases to the DoH. The DoH must then approve these price increases within 30 days of receipt of an application by the manufacturer.

According to the DoH, the introduction of the SEP resulted in an average reduction in medicine prices of 19% in South Africa.

4. NEW INTELLECTUAL PROPERTY RIGHTS (“IP”) POLICY

Patent protection promotes innovation in the pharmaceutical industry by allowing originator brand companies to recoup the costs of their innovations and to prevent free riding. The interaction between IP, which rewards innovators by granting them some protection from competition, and competition law, which seeks to ensure a competition and limit the creation or maintenance of monopoly power has attracted growing attention, particularly because of the expansion of IP law at the global scale.

On 4 September 2013, the South African government published a draft documenting its new policy stance on IP in South Africa. The final document on IP policy has not been published as yet. The essence of the new IP policy captures a move from a depository patenting system to a substantive patenting system. This means that patent applications would have to undergo intense scrutiny in order to prove that a patentable product is novel and that an inventive step has been taken rather than merely ticking off a set of requirements. Secondly it allows for pre- and post- patent approval opposition. Thirdly it advocates the integration of databases between the patent office and the Medical Control Council (MCC) in order to share information. This will limit the granting of some second generation patents. Lastly the new IP policy also allows South Africa to take advantage of the flexibilities granted to developing countries under the TRIPS agreement. These flexibilities include making use of parallel imports, compulsory licensing and the Bolar provision. The amendment of South Africa’s IP policy is a step forward in creating a more competitive pharmaceutical sector.

5. CONCLUSION

The Commission is currently undertaking a market inquiry into private healthcare. The major focus of this market inquiry is on private hospitals, medical schemes and other healthcare related goods and services which include doctors, specialists, nurses, pathologists, medical devices and pharmaceuticals. The relationship between pharmaceutical manufacturers and other stakeholders such as doctors, hospitals and retail pharmacy will be the subject of the inquiry. The purpose is to understand how pharmaceuticals act as a cost driver in private healthcare. This analysis however does not take into account a full investigation into the pharmaceutical sector but the Commission reserves the right to extend the scope of the inquiry if there are grounds to do so.

REFERENCE

Plastic pipes are an integral part of infrastructure and construction work in South Africa. They are also used in various other applications such as mining, agriculture and telecommunications. Competitive dynamics in the plastic pipes market therefore affect various sectors of the economy, and it is not surprising that this is one of the areas where the Commission focused its efforts in recent years. The initial investigation conducted by the Commission in the plastic pipes market was a merger filed by DPI Plastics (DPI) in 2007, in terms whereof it planned to acquire Incledon Cape (Pty) Ltd (Incedon Cape). During the investigation of this proposed merger, the Commission was alerted to possible cartel conduct between the merging firms and other competitors in the supply and distribution of plastic pipes and fittings to municipalities and other customers in the Western Cape. The proposed merger was prohibited on the grounds that it raised concerns that it would facilitate and strengthen on-going cartel conduct, while raising barriers to entry in these markets.

Incidentally, between 2004 and 2006, the increase in the producer price inflation (PPI) for plastic pipes was approximately 14%, and the increase in polyvinyl chloride (PVC) pipes PPI for the same period was 8%.

The Commission’s subsequent investigation into the alleged cartel confirmed that several firms i.e. DPI, Petzetakis Africa (Pty) Ltd (Petzetakis), Marley Pipe Systems (Pty) Ltd (Marley), Amitech South Africa (Pty) Ltd (Amitech) and Swan Plastics (Pty) Ltd (Swan) were involved in price fixing, market allocation and collusive tendering in the manufacture of PVC and high density polyethylene (HDPE) pipes. This practice was prevalent in KwaZulu-Natal, Eastern Cape, Western Cape and Gauteng provinces, and also involved distributors of plastic pipes. Evidence collected by the Commission also suggested that the cartel was in place for at least 20 years.

Some of the firms implicated have since admitted that they were members of the cartel and have settled with the Commission, while others were fined by the Tribunal and the Competition Appeal Court for their participation in the cartel.

The successful prosecution and “breaking-up” of the plastic pipes cartel resulted in some significant developments in the plastic pipes market. These developments are depicted in Figure 1 and explained in some detail below.

Most notably was the exit of Petzetakis, one of the three leading manufacturers of PVC and HDPE products, and one of the ring leaders in the cartel. Petzetakis ceased operating in December 2010, almost 2 years after the Commission referred its complaint to the Tribunal in February 2009.

Other firms that have since exited the plastic pipes market, and were part of the cartel include Amitech, Swan and Gazelle Plastics. The exit of firms in the plastic pipes market was, however, not only limited to firms implicated in the cartel, but extended to other smaller PVC and HDPE manufacturers not implicated in the cartel conduct, such as Praysa, Polyflair and Vumani.

The exit by these firms has resulted in new entry as well as consolidation in the plastic pipes market. In terms of entry,
Table 1: Market share for HDPE pipes

<table>
<thead>
<tr>
<th>Manufacturer</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sangio</td>
<td>42%</td>
<td>35%</td>
<td>25%</td>
<td>19%</td>
</tr>
<tr>
<td>DPI</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Marley</td>
<td>22%</td>
<td>26%</td>
<td>14%</td>
<td>14%</td>
</tr>
<tr>
<td>Flotek</td>
<td>29%</td>
<td>33%</td>
<td>23%</td>
<td>17%</td>
</tr>
<tr>
<td>Gradco</td>
<td>-</td>
<td>-</td>
<td>6%</td>
<td>7%</td>
</tr>
<tr>
<td>Vergenoeg</td>
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<td>-</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>Rho-Tek</td>
<td>6%</td>
<td>5%</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>Pexmart</td>
<td>-</td>
<td>-</td>
<td>2%</td>
<td>6%</td>
</tr>
<tr>
<td>Macneil</td>
<td>-</td>
<td>-</td>
<td>21%</td>
<td>17%</td>
</tr>
<tr>
<td>Rare</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>13%</td>
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<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
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</table>

Table 1 shows that at least five new firms have entered the HDPE pipes manufacturing market in the past two years, and the largest proportion of this new capacity is from investments by Pexmart and Rare. The impact of this new entry has been to take away some market share from the incumbents e.g. by winning public sector tenders which form the largest source of revenue for competitors in these markets.

Table 2: Market share for PVC pipes

<table>
<thead>
<tr>
<th>Manufacturer</th>
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</table>

The other significant development observed in the plastic pipes market has been consolidation by the incumbent firms. These acquisitions were notified to the Commission, and involved DPI and Marley. In 2011, Marley acquired the business and related assets of Petzetakis. This transaction was approved subject to an employment condition which at present is the subject of litigation at the Tribunal. During 2013, DPI acquired Swan (a manufacturer of PVC pipes), while in 2014 DPI acquired Sangio Pipe (Pty) Ltd (Sangio), a manufacturer of HDPE pipes. The DPI transactions were approved by the Commission as it found that competitors of the merged entity have spare capacity to meet an increase in demand and to counter any potential price increases, while barriers to entry and expansion appeared to be low as evidenced by recent entry and expansion.

Other merger transactions involving smaller firms in the plastic pipes market include an acquisition of Gazelle Engineering (Pty) Ltd by First Strut (Flexicon) which was approved by the Commission in 2010. In 2011, First Strut (Gazelle and Flexicon) acquired Sibanyoni Mining and Industrial Supplies cc. In 2013, Rare acquired the extrusion equipment of First Strut/First Tech Piping when First Tech Piping went into liquidation. None of these transactions raised any competition concerns.

These developments in the plastic pipes market suggest that the strategy adopted by some firms post the cartel conduct has been to either exit or to consolidate to survive.

The demise of some firms could have been partly caused by the inability to compete effectively in the absence of a cartel. Firms, during some of the merger investigations, have indicated that there is heightened rivalry in the plastic pipes market, especially after the dismantling of the cartel by the competition authorities.

Since a large proportion of sales of firms is also through public sector tenders, this affects the ability of firms to maintain stable market share over time without explicit coordination. The global financial crisis around the time the Commission uncovered cartel conduct in plastic pipes is likely to have also negatively affected various industries such as construction and infrastructure. The PVC market, in particular, typically expands and contracts in line with market activity in these sectors.

The plastic pipes market is however still characterised by a few large firms operating nationally and competing against small firms that do not have a national reach. It is increasingly evident that large firms in the plastics market are consolidating their operations through mergers, despite the entry of new regional players. Although mergers can be pro-competitive, there is cause for concern when such market activity follows the demise of a long standing cartel. This is because mergers can be considered as a second best alternative to a cartel, and may be used as a mechanism to formalise cartels. Recent investigations point to the emergence of new market players that could disrupt any potential coordination in the PVC and HDPE pipes market, given the existing excess capacity and potential for further new entry. However, it is still early to predict with certainty how this sector will unravel post the cartel.

The other leading manufacturers are DPI and Marley. In 2012, Gazelle Plastics exited the PVC pipes market and was only supplying HDPE to the mining sector.
The Research Programme on Competition Dynamics and Regional Trade Flows conducted under the ACF focused on the links between competition and development. The research work was being conducted on three key industries within the region: cement, by Botswana, Kenya, Namibia, South Africa, Tanzania and Zambia; sugar, by Kenya, Tanzania, South Africa and Zambia; and finally poultry by Botswana, Namibia, South Africa and Zambia. This article summarises the four countries’ (Kenya, South Africa, Tanzania and Zambia) findings on the sugar industry.

Introduction and Background

The sugar industry within the Southern and Eastern Africa region is an important one in so far as it generally encompasses several linkages to the local economies and domestic markets in which it operates. The sugar industries in each of the focus countries are well-established, and some have developed from as early as the eighteenth century. In-country expansions of the sugar industry began intensely in South Africa and then extended to neighbouring countries. The northward expansion of these early sugar producers has given rise to a regional sugar economy with an international impact. The expansion has been accompanied by changing patterns of ownership and control. Besides corporate strategies, the respective countries’ response to industrial growth and more so in the sugar sector helped shape the growth of the industry in the region.

Cross border investments were largely encouraged by favourable export quotas offered to former British colonies by the 1951 Commonwealth Sugar Agreement, while buoyant world sugar prices in the late 1950s provided further impetus. Changing patterns of ownership and control were also observed, the early acquisitions were by Hulett’s, an Anglo-American sugar company based in South Africa. Illovo’s acquisitions of other sugar companies over time are perhaps the most elaborate with far reaching effects on the structure of the sugar industry in Southern Africa. The majority of their acquisitions took place in 1990s to the 2000s.

The changes have brought the Southern African sugar industry under the control of Illovo and Tongaat Hulett. Illovo is the strongest sugar corporation in the region and in Africa. By 2012, Illovo points out that the company was Africa’s largest sugar producer with extensive agricultural and manufacturing assets in six Southern African countries. The company’s sugarcane output was in excess of six million tons while its milling capacity was in excess of two million tons of sugar per annum. Zambia’s sugar industry has evolved since the 1960s following the establishment of Nakambala Sugar Estates which was nationalised to become Zambia Sugar in the early 1970s following the attainment of independence. In 1995, it was privatised and Illovo Group of South Africa purchased majority shares. Since then, Zambia had two new mills established in 1999 and 2004.

In Eastern Africa, the Kenya Sugar Board (KSB) started in the 1920s with the establishment of two private sugar mills and they dominated the sugar industry until 1966 when the government established Muhoroni Sugar Company. From that period there were several changes with state-owned sugar factories increasing. The disequilibrium between supply and demand for sugar in Kenya has subsequently attracted new private mills.

On the other hand, the sugar industry in Tanzania dates back to the early 1960s and until 1998, sugar factories in Tanzania were 100% government owned. Sugar distribution was monopolized by the government parastatal, Sukari Development Company (SUDECO), which purchased sugar and distributed it to regions according to allocation quotas fixed on the basis of population. From 1998, the Tanzanian government decided to privatize factories as part of the Structural Adjustment Programme (SAPs). Multinational Illovo purchased part of the shareholding and now operates as Kilombero Holdings. After liberalization of trade and privatization, sugar production and distribution was left to manufacturers.

Summary of Findings

The following provides an overview of the findings of the sugar study.

a. Government support in the sugar industry has assisted industries to develop but it has also distorted competitive outcomes to the detriment of consumers in some cases. For instance, government is the largest shareholder in the sugar mills in Kenya and the same time involved in regulation including the approval of import permit applications. These non-tariff barriers play an important role in constraining regional trade in sugar. This aspect, coupled with the inability of local millers to produce enough sugar to meet domestic demand, has maintained disequilibrium in the sugar market in Kenya with supply always falling below demand. The sugar industry in Tanzania is highly regulated, both within and outside the country. Within the country, the Sugar Industry Act of 2001 is the main piece of legislation that governs sugar trading. The regulations start at the farm level where farmers are required to adhere to standards approved by the Tanzania Sugar Board.
c. Sugar milling operations typically operate in conjunction with out-growers from the same local areas in which the mill is located – this results in local economic development, but also manifests a relationship whereby growers are beholden to their nearest local miller through vertical arrangements. The proportion of sugarcane supply from out-growers varies quite substantially across the focus countries. In Kenya out-growers provide approximately 92% of the crushed cane which is similar to South Africa where out-growers contribute approximately 93%. In Tanzania out-growers provide approximately 78% of cane. In Zambia the picture is quite different with 40% of supply being contributed by out-growers. In each case, the vertical relationships between millers and out-growers necessitate cane supply agreements and out-grower schemes between millers and growers. In each country the relevant Sugar Act provides for negotiated agreements between an individual miller and grower which stipulates the terms and conditions of sugarcane production, the rights and obligations of growers and millers, planting, crop husbandry, harvesting plans as well as payment mechanisms. In these agreements the miller commits to maintain and develop adequate milling capacity for the sugarcane planted on the basis of agreed planting plans with the grower, to operate the factory for a sufficient period in each year to enable the grower to supply all of their cane to the miller, and to maintain certain payment terms based on the pricing for cane recommended by the relevant industry association. These contracts are typically negotiated between individual millers and growers. Growers are not coordinated in their decision making, which diminishes the potential for collective bargaining power vis-à-vis millers.

d. The nature of sugarcane farming, whereby cane deteriorates in recoverable value if there are delays between the time when it is cut and when it is crushed, reinforces the environment in which cane growers are beholden to their local miller. In some markets this has served to diminish any potential for meaningful competitive rivalry between millers for the supply of sugarcane to their mills. For different reasons, milling companies will tend to produce and sell their sugar products within the domestic markets in which they operate. Exports to net-importing countries within the region are not as high as would be expected when domestic prices and costs of production are compared.

e. The distortions in competitive rivalry between milling companies within countries and across the region are substantially overshadowed by tacit and explicit barriers to entry and expansion created by regulatory processes and policies within countries.

f. Regulatory barriers and capital requirements are substantial. In recent investigations in South Africa the cost of replacing or establishing a new refinery was estimated to be approximately $0.2 billion for a mill that can crush just more than 1 million tons of cane per annum. This does not account for the annual costs of maintaining the mill which are approximately $3 million per year. According to millers it can take about 2 to 4 years for the mill to become fully operational. There has been new entry in milling, namely, Kenya and Tanzania. South Africa has experienced no greenfields entry in the past decade.

g. Access to European markets through preferential access agreements distorts the possibility for intra-regional trade in sugar between countries such as Zambia and South Africa which are 'low-cost' net-exporters, and Kenya and Tanzania which are net-importers. The South African sugar industry does not benefit from preferential access to lucrative markets such as the EU and the US which countries such as Zambia, Zimbabwe, Swaziland and other LDC members enjoy. The domestic producers therefore rely on maintaining a higher price in the domestic market in order to sustain their operations.

h. In terms of sugar prices, among the countries under review, Kenya has the highest ex-factory prices followed by Zambia while Tanzania and South Africa have lower ex-factory prices.

i. The South African market is a relatively mature market and as such growth is limited despite what is effectively government sanctioned coordination within the industry. The domestic sugar market is further ‘ring-fenced’ by a series of regulations administered by the South African Sugar Association (SASA) which is legislated under the current Sugar Act No. 9 of 1978, in order to protect it from a distorted and heavily protected world market. According to the Department of Trade and Industry (DTI), the protection afforded to the domestic sugar industry has allowed it to increase its production capacity to almost double the domestic requirements for sugar while at the same time ensuring economies of scale through sugar exports.

j. From the late 1990s and well into the 2000s multinational firms such as Illovo Sugar Ltd from South Africa have intensified the expansion of their operations into other countries within the region such as Tanzania, Zimbabwe and Zambia. This is seemingly in response to more favourable terms of trade in countries such as Zambia where favourable barriers to (further) entry and the possibility of cross-subsidization by trading with more lucrative markets such as the EU, have allowed Illovo to accumulate a position of entrenched dominance.

k. Large milling firms have been able to exert a degree of market power in some of the markets which have been analysed, e.g. Zambia and South Africa. This is evidenced by the fact that there has been limited new entry to these large markets in recent years. Instead we observe that close relationships between these multinationals and governments have resulted in stable, non-competitive markets where these firms have been able to leverage the favourable regulatory environment to the benefit of their international shareholders.

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2 The percentage for Zambia is an approximation based on the hectares of land under cane in the hands of out-growers versus nucleus estates and not based on the source of sugarcane crushed at mills.
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